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

FORM 10-Q

(Mark One)

☑ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED DECEMBER 31, 2012 OR**

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

Commission File Number: N/A

UNITED STATES POSTAL SERVICE

(Exact name of registrant as specified in its charter)

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

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

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

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

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

Large accelerated filer ☐ Accelerated filer ☐

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

Not Applicable ☑

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

Common Stock	Outstanding Shares as of February 8, 2013
No Common Stock	N/A

United States Postal Service
Quarterly Financial Report Index

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Part I

Item 1 – Financial Statements

United States Postal Service
Statements of Operations
(Unaudited)

	Three Months Ended December 31,	
(Dollars in millions)	2012	2011
Operating revenue	$ 17,660	$ 17,677
Operating expenses:		
Compensation and benefits	12,467	12,486
Retiree health benefits	2,078	3,680
Workers' compensation	324	745
Transportation	1,839	1,766
Other	2,172	2,246
Total operating expenses	18,880	20,923
Loss from operations	**(1,220)**	**(3,246)**
Interest and investment income	6	6
Interest expense	(50)	(47)
Net loss	**$ (1,264)**	**$ (3,287)**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Balance Sheets - Assets

(Dollars in millions)	December 31, 2012	September 30, 2012
	(Unaudited)	(Audited)
Current Assets		
Cash and cash equivalents	$ 2,912	$ 2,319
Receivables:		
Foreign countries	552	509
U.S. government	78	142
Other	334	308
Receivables before allowances	964	959
Less: Allowances	38	41
Total receivables, net	926	918
Supplies, advances and prepayments	173	126
Total Current Assets	**4,011**	**3,363**
Noncurrent Assets		
Property and equipment, at cost:		
Buildings	24,467	24,452
Equipment	20,059	20,143
Land	2,911	2,919
Leasehold improvements	1,232	1,208
	48,669	48,722
Less: Allowances for depreciation and amortization	30,437	30,187
	18,232	18,535
Construction in progress	282	328
Total property and equipment, net	18,514	18,863
Other assets - principally revenue forgone receivable	380	385
Total Noncurrent Assets	**18,894**	**19,248**
Total Assets	**$ 22,905**	**$ 22,611**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Balance Sheets - Liabilities and Net Deficiency

(Dollars in millions)	December 31, 2012 (Unaudited)	September 30, 2012 (Audited)
Current Liabilities		
Compensation and benefits	$ 2,899	$ 1,856
Retiree health benefits	12,632	11,205
Workers' compensation	1,341	1,337
Payables and accrued expenses:		
Trade payables and accrued expenses	1,024	1,159
Foreign countries	633	583
U.S. government	97	93
Total payables and accrued expenses	1,754	1,835
Deferred revenue-prepaid postage	4,226	4,014
Customer deposit accounts	1,259	1,210
Outstanding postal money orders	641	677
Prepaid box rent and other deferred revenue	446	475
Short-term portion of debt	9,500	9,500
Total Current Liabilities	**34,698**	**32,109**
Noncurrent Liabilities		
Workers' compensation costs	15,196	16,230
Employees' accumulated leave	1,873	1,855
Deferred appropriation and other revenue	195	194
Long-term portion capital lease obligations	395	410
Deferred gains on sales of property	311	313
Contingent liabilities and other	847	846
Long-term portion of debt	5,500	5,500
Total Noncurrent Liabilities	**24,317**	**25,348**
Total Liabilities	**59,015**	**57,457**
Net Deficiency		
Capital contributions of the U.S. government	3,132	3,132
Deficit since 1971 reorganization	(39,242)	(37,978)
Total Net Deficiency	**(36,110)**	**(34,846)**
Total Liabilities and Net Deficiency	**$ 22,905**	**$ 22,611**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Changes in Net Deficiency
(Unaudited)

(Dollars in millions)	Capital Contributions of U.S. Government		Deficit Since Reorganization		Total Net Deficiency	
Balance, September 30, 2011	$	3,132	$	(22,072)	$	(18,940)
Net loss		-		(3,287)		(3,287)
Balance, December 31, 2011	**$**	**3,132**	**$**	**(25,359)**	**$**	**(22,227)**
Balance, September 30, 2012	$	3,132	$	(37,978)	$	(34,846)
Net loss		-		(1,264)		(1,264)
Balance, December 31, 2012	**$**	**3,132**	**$**	**(39,242)**	**$**	**(36,110)**

See accompanying notes to the financial statements. (unaudited)

United States Postal Service
Statements of Cash Flows
(Unaudited)

(Dollars in millions)	Three Months Ended December 31, 2012	Three Months Ended December 31, 2011
Cash flows from operating activities:		
Net loss	$ (1,264)	$ (3,287)
Adjustments to reconcile net loss to cash provided by operations:		
Depreciation and amortization	483	545
Loss (gain) on disposals of property and equipment, net	3	(16)
Increase in other assets - primarily appropriations receivable revenue forgone	5	20
Decrease in noncurrent workers' compensation liability	(1,034)	(601)
Increase (decrease) in noncurrent employees accumulated leave	18	(22)
Increase (decrease) in noncurrent deferred appropriations and other revenue	13	(1)
Increase (decrease) in other noncurrent liabilities	1	(8)
Changes in current assets and liabilities:		
Receivables, net	(8)	(61)
Supplies, advances and prepayments	(47)	(52)
Compensation and benefits	1,043	118
Retiree health benefits	1,427	3,068
Workers' compensation	4	73
Payables and accrued expenses	(81)	(75)
Customer deposit accounts	49	(38)
Deferred revenue-prepaid postage	212	201
Outstanding postal money orders	(36)	5
Prepaid box rent and other deferred revenue	(31)	(29)
Net cash provided by (used in) operating activities	757	(160)
Cash flows from investing activities:		
Purchases of property and equipment	(166)	(251)
Proceeds from sales of property and equipment	29	47
Net cash used in investing activities	(137)	(204)
Cash flows from financing activities:		
Issuance of notes payable	2,700	2,500
Payments on notes payable	(2,700)	(2,500)
Net change in revolving credit line	-	(97)
Payments on capital lease obligations	(15)	(9)
U.S. government appropriations - expensed	(12)	(16)
Net cash used in financing activities	(27)	(122)
Net increase (decrease) in cash and cash equivalents	593	(486)
Cash and cash equivalents at beginning of year	2,319	1,488
Cash and cash equivalents at end of period	**$ 2,912**	**$ 1,002**
Supplemental cash flow disclosures:		
Interest paid	$ 50	$ 44

See accompanying notes to the financial statements. (unaudited)

Notes to Financial Statements (Unaudited)

Note 1 – Basis of Presentation

The interim financial statements have been prepared in accordance with United States (U.S.) generally accepted accounting principles (GAAP) for interim financial statements and, accordingly, do not include all the information and footnotes required by GAAP for complete financial statements. These interim financial statements should be read in conjunction with the significant accounting policies and other disclosures in the Annual Report on Form 10-K for the year ended September 30, 2012. As in the Annual Report on Form 10-K, all references to years are to the fiscal year beginning October 1 and ending September 30, unless otherwise stated. All references to quarters, unless otherwise indicated, are to quarters within fiscal years 2013 and 2012.

In the opinion of management, the accompanying unaudited interim financial statements reflect all adjustments (including normal recurring adjustments) necessary to fairly present the financial position of the Postal Service as of December 31, 2012, and the results of operations and cash flows for the three months ended December 31, 2012, and 2011. Operating results for the three month period ended December 31, 2012, are not necessarily indicative of the results that may be expected for all of fiscal year 2013. Subsequent events have been evaluated through February 8, 2013, the date the Postal Service filed its Form 10-Q for the quarter ended December 31, 2012, with the Postal Regulatory Commission (PRC).

The Postal Service has significant transactions with other U.S. Government agencies, as disclosed throughout this report. In addition to the amounts disclosed elsewhere, deferred revenue of $24 million at December 31, 2012, and $27 million at September 30, 2012, related to government deposits are included in the Balance Sheets in "Customer Deposit Accounts".

Note 2 – Liquidity

LIQUIDITY CONCERNS

The Postal Service continues to suffer from a severe lack of liquidity. The Postal Service held total cash of $2.9 billion and $2.3 billion as of December 31, and September 30, 2012, respectively, and had no remaining borrowing capacity on its $15 billion debt facility (See Note 3, *Debt*, for additional information). The increase in cash balances for the quarter is largely attributable to the seasonal impact of holiday mailings, along with additional revenue resulting from this year's political campaign and elections. Cash balances generally decline during the remainder of the fiscal year, as revenue is not as strong in the remaining quarters. By the end of this fiscal year, the Postal Service projects it will have a liquidity balance that will be less than its average weekly expenses of $1.3 billion. This low level of available cash means that the Postal Service will be unable to make the $5.6 billion legally-mandated prefunding of retiree health benefits due by September 30, 2013. Further, this level of cash could be insufficient to support operations in the event of another significant downturn in the U.S. economy.

Through the three months ended December 31, 2012, the Postal Service has suffered 5 quarters of consecutive net losses and net losses in 14 of the last 16 quarters. The net loss of $1.3 billion for the first quarter of the year included $1.4 billion of expense accrued for the legally-mandated prefunding payment for retiree health benefits. The requirement of the *Postal Accountability and Enhancement Act,* Public Law 109-435 (P.L. 109-435) to prefund its retiree health benefit obligations, a requirement not shared by other federal agencies or private sector businesses, plus the precipitous drop in mail volume caused by changes in consumers' uses of mail, have been the two major factors contributing to Postal Service losses since the recession ended in 2009. Without structural change to the Postal Service's business model, it will continue to be negatively impacted by these factors and, absent legislative change, it anticipates continuing quarterly losses for the remainder of 2013.

The retiree health benefits prefunding requirement of $5.6 billion for 2013 is in addition to paying the employers' share of the insurance premiums for the Postal Service's retirees, which cost $2.6 billion in 2012. In the past six fiscal years, since the enactment of the Congressionally-mandated prefunding, the Postal Service has incurred $41 billion of net losses, including $32 billion of expenses for prefunding retiree health benefits. The Postal Service has paid $21 billion of cash into the PSRHBF for prefunding through 2011; however, it defaulted on $11.1 billion of prefunding obligations during 2012. Since 2006, its debt has increased by nearly $13 billion, reaching the $15 billion borrowing limit at the end of 2012.

During 2012, the Postal Service was forced to default on $11.1 billion of required prefunding payments to the PSRHBF for retiree health benefits. The statutory requirement establishing the prefunding payment schedule, P.L. 109-435, contains no provisions addressing a payment default. This $11.1 billion is currently reflected as a liability in the Balance Sheets. As of the date of this report, February 8, 2013, the Postal Service has suffered no penalties as a result of our inability to make these payments.

The Postal Service was able to make its annual payment of approximately $1.4 billion to reimburse the Department of Labor (DOL) for workers' compensation expenses in October 2012. However, current projections indicate that it will once again have a low level of liquidity in the second half of 2013. It is expected that the Postal Service will be unable to make the required $5.6 billion retiree health benefits prefunding payment due by September 30, 2013, and will continue to have no ability to borrow additional funds at that date. This cash position will continue to worsen in October 2013, when the Postal Service is required to make its annual payment of approximately $1.4 billion to the DOL for workers' compensation. Absent the legislative actions by Congress that have been requested to assist the Postal Service in returning to a financially stable position, this low level of liquidity will continue to exist.

In the short-term, should circumstances leave the Postal Service with insufficient cash, it will be required to implement contingency plans to ensure that mail deliveries continue. These measures could require that the Postal Service prioritize payments to our employees and suppliers ahead of those to the Federal Government, as has been done in the past. Additionally, the Postal Service continues to seek a refund of the overfunding of Federal Employees' Retirement System (FERS) as those funds would help alleviate some of the Postal Service's short-term liquidity risks. The Office of Personnel Management (OPM) estimates that the FERS overfunding was $3.0 billion at September 30, 2012. The Office of the Inspector General (OIG) has determined that if Postal Service specific assumptions were used to estimate the FERS obligation, rather than the government-wide averages currently used, the surplus would be greater than the amount calculated by OPM.

POSTAL ACTIONS TAKEN TO IMPROVE LIQUIDITY

The Postal Service continues to aggressively pursue strategies within its control to increase efficiency and to improve its liquidity position. These measures include consolidating the mail processing, retail, and delivery networks in order to better align them with mail volumes, pursuing new revenue streams, and reducing workforce costs.

During 2012, the Postal Service announced detailed plans to implement these strategies, and actions are underway to increase the productivity of the mail processing, delivery and retail networks. This requires the consolidation of a number of mail processing and distribution locations and the rescheduling of transportation routes, while continuing to deliver appropriate levels of service to communities throughout America.

On January 14, 2013, citing the fact that the Postal Service cannot wait indefinitely for legislation, the Postal Service Board of Governors directed management to accelerate the restructuring of Postal Service operations to further reduce costs in order to strengthen Postal Service finances. On February 6, 2013, the Postal Service announced plans to transition to a new delivery schedule during the week of August 5, 2013, that includes package delivery Monday through Saturday and mail delivery Monday through Friday. The Postal Service expects to generate cost savings of approximately $2 billion annually, when the change in delivery frequency is fully implemented.

The Postal Service also continues to introduce new service offerings and use educational marketing information to generate new revenue and slow the migration of existing revenue streams to electronic alternatives. Major advertising campaigns promote mail as a powerful way for businesses to reach and engage their customers. However, it is not possible to achieve financial stability through revenue initiatives alone without a fundamental change in the business model.

As the Postal Service implements these efficiency measures, it plans to continue its actions to better align staffing levels with projected mail volume. This will be achieved largely through attrition, as approximately one-half of career employees are eligible for retirement or voluntary early retirement. Special Incentive and Voluntary Early Retirement (VER) offers were accepted by approximately 22,500 eligible American Postal Workers' Union (APWU) employees by January 31, 2013, 6,000 of whom were locked-in by December 31, 2012. This follows the 4,275 eligible postmasters and 2,925 eligible mail handlers who retired or separated from the Postal Service in Quarter IV, 2012. In addition, recent contractual agreements with major postal unions allow for increased utilization of non-career employees, which will facilitate the realignment of staffing and workload levels and the reduction of costs.

Achieving significant future efficiencies and cost reductions in areas that are under the Postal Service's control will not be enough to return it to a position of financial viability in the long run without comprehensive changes to its business model. Accordingly, the Postal Service has proposed legislative changes to Congress that are needed to provide it with the legal authority to implement certain measures to increase efficiency and produce additional cost savings. Certain parts of the plan, such as resolving the prefunding of retiree health benefits and obtaining a refund of the FERS overfunding, may be beyond the control of management because they require enactment of legislation or legislative restraint. The legislative process started anew with the 113th Congress which began in January 2013. Given the vital role that the Postal Service plays in the U.S. economy, management is requesting that Congress promptly take the steps needed to enact legislative changes that will enable the Postal Service to return to financial stability.

A vital component of the five-year plan is the proposal that the Postal Service sponsor its own health care program independent of other federal health insurance programs. A Postal Service-sponsored health care program could achieve over $7 billion of projected annual savings. The plan would allow for the elimination of the retiree health benefit prefunding obligation established in P.L. 109-435, which would save the Postal Service over $5 billion annually through 2016. The plan also proposes to transfer current retirees into the Postal Service-sponsored health care program, an action that requires legislation.

MITIGATING CIRCUMSTANCES

The Postal Service's status as an independent establishment of the executive branch that does not receive tax dollars for its operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With revenues of $65 billion, generated almost entirely through the sale of postage, a financially sound Postal Service is vital to American commerce. The U. S. economy benefits greatly from the Postal Service and the many businesses that provide the printing and mailing services that support it. Disruption of the mail would cause hardships to consumers, and could cause many businesses to literally shut down. Therefore, it is unlikely that, in the event of a cash shortfall, the Federal Government would allow the Postal Service to significantly curtail or cease operations.

The Postal Service continues to inform the Administration, Congress, the Postal Regulatory Commission (PRC), and other stakeholders of the immediate and longer-term financial issues it faces and the legislative changes that would help provide financial stability. Given the vital role the Postal Service plays in the U.S. economy, it is hopeful that Congress will promptly enact, and the President will sign, legislation which will mitigate the Postal Service's short-term financial challenges and provide it with the authority to make needed changes to ensure long-term financial stability. However, there can be no assurances that the requests to restructure the PSRHBF prefunding payment schedule, or any other legislative changes, will be made in time to impact 2013, or at all.

Note 3 – Debt

Debt payable to the Federal Financing Bank (FFB), a government-owned corporation under the general supervision of the Secretary of the Treasury, consisted of the following at December 31, 2012, and September 30, 2012:

Indebtedness to Federal Financing Bank

(Dollars in millions)

		December 31, 2012		September 30, 2012	
Maturity	**Debt Type**	**Balance**	**Rate %**	**Balance**	**Rate %**
Fixed rate notes - short-term					
November 14, 2013	Fixed rate-payable at maturity	$ 1,300	0.293	$ 1,300	0.227
May 30, 2013	Fixed rate-payable at maturity	1,200	0.298	1,200	0.298
September 19, 2013	Fixed rate-payable at maturity	500	0.299	500	0.299
Fixed rate notes - long-term					
January 31, 2014	Fixed rate-payable at maturity	300	2.035	300	2.035
May 2, 2016	Fixed rate-payable at maturity	300	2.844	300	2.844
November 15, 2018	Fixed rate-payable at maturity	500	3.048	500	3.048
February 15, 2019	Fixed rate-payable at maturity	700	3.296	700	3.296
May 15, 2019	Fixed rate-payable at maturity	1,000	3.704	1,000	3.704
May 15, 2019	Fixed rate-payable at maturity	500	3.513	500	3.513
August 16, 2021	Fixed rate-payable at maturity	1,000	2.066	1,000	2.066
May 17, 2038	Fixed rate-payable at maturity	200	3.770	200	3.770
February 15, 2039	Fixed rate-payable at maturity	1,000	3.790	1,000	3.790
Floating rate notes and revolving credit line - short-term					
June 19, 2013	Floating rate[1]	500	0.175	500	0.236
September 18, 2013	Floating rate[2]	600	0.168	600	0.231
October 17, 2013	Floating rate[3]	700	0.247	700	0.228
December 17, 2013	Floating rate[4]	700	0.199	700	0.227
	Short-term revolving credit line	3,400	0.135	3,400	0.176
	Overnight revolving credit line	600	0.145	600	0.186
Total debt		**$ 15,000**		**$ 15,000**	
Current portion of debt		**$ 9,500**		**$ 9,500**	
Long-term portion of debt		**$ 5,500**		**$ 5,500**	

[1] Floating Rate Note- Repurchasable at par on each interest rate reset date and the interest rate resets on March 19, 2013.

[2] Floating Rate Note- Repurchasable at par on each interest rate reset date and the interest rate resets on March 18, and June 18, 2013.

[3] Floating Rate Note- Repurchasable at par on each interest rate reset date and the interest rate resets on January 17, April 17, and July 17, 2013.

[4] Floating Rate Note- Repurchasable at par on each interest rate reset date and the interest rate resets on March 18, June 17, and September 17, 2013.

The Postal Service has two revolving credit lines with the FFB, both of which are available until May 2013. One, a short-term credit line, enables it to draw up to $3,400 million with two days prior notice. Borrowings under this credit line are typically on an overnight basis, but can have a maximum term of up to one year. The second credit facility, which only allows for borrowings on an overnight basis, enables borrowings of up to $600 million on the same business day that funds are requested. In addition, the Postal Service can use a series of other notes with varying provisions to draw upon with two days prior notice. These credit facilities and note arrangements provide the flexibility to borrow short- or long-term, using fixed- or floating-rate notes. Fixed-rate notes can be either callable or non-callable at the option of the Postal Service. Debt, all of which is unsecured and not subject to sinking fund requirements, can be repaid at any time at a price determined by the Secretary of the Treasury, based on prevailing interest rates in the Treasury Security market at the time of repayment.

The Postal Service is limited by statute to net annual debt increases of $3 billion, and total debt cannot exceed $15 billion. For 2013, the amount of borrowing is constrained by the total debt ceiling limitation of $15 billion, which the Postal Service reached during fiscal year 2012. The total debt as of December 31, and September 30, 2012, was $15 billion.

Scheduled principal repayments, exclusive of capital leases, as of December 31, 2012, are as follows:

Scheduled Debt Principal Repayments - By Fiscal Year (Dollars in millions)		
2013	**$**	**6,800**
2014		**3,000**
2015		**-**
2016		**300**
2017		**-**
After 2017		**4,900**
Total Debt	**$**	**15,000**

Note 4 – Property and Equipment

Property and equipment are recorded at cost which includes the interest on borrowings used to pay for the construction of major capital additions, less accumulated depreciation. Interest capitalized during the three month periods ended December 31, 2012, and 2011, was not significant. Property and equipment are depreciated over estimated useful lives that range from 3 to 40 years, except for buildings with historic status, which are depreciated over 75 years, using the straight-line method.

In September 2011, the Postal Service announced plans to realign its mail processing, delivery, and retail networks. These plans continue to be updated for maximum operating and cost efficiencies. See Note 2, *Liquidity,* for details. As a result, an assessment was performed on both the real estate and equipment associated with the proposed realignment efforts to determine if any impairment should be recognized. Any facility lacking utility to the realigned mail processing, distribution, and retail networks will be marked for disposal. Once a facility is marked for disposal, determination of impairments, if any, will be made by management. As of December 31, 2012, these evaluations are ongoing. For the three months ended December 31, 2012, there were no significant impairment charges related to these plans.

Assets classified as held for sale of $88 million as of December 31, 2012, and $111 million as of September 30, 2012, are included on the Balance Sheets in “Land” and “Buildings”. There were no impairment charges for the three month period ended December 31, 2012, while impairment charges were $27 million for same period last year. Impairment charges are included in the Statement of Operations in “Other.”

Deferred gains on sales of property are recognized in income and the sold assets removed from the accounting records when any lease-backs or other conditions requiring continued Postal Service involvement in the properties have expired. Deferred gains recognized in income were not material for the three months ended December 31, 2012, and were $43 million for the three months ended December 31, 2011.

Note 5 – Leases and Other Commitments

Leases

At December 31, 2012, the future minimum payments on non-cancelable operating and capital leases were as follows:

Lease Obligations (Dollars in millions)		Operating		Capital
(Unaudited)				
2013	$	557	$	73
2014		677		92
2015		618		90
2016		550		87
2017		484		78
After 2017		3,900		214
Total Lease Obligations	$	6,786	$	634
Less: Interest				181
Total Capital Lease Obligations				453
Less: Current Portion of Capital Lease Obligations				58
Noncurrent portion of Capital Lease Obligations			$	395

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

Rent expense for the three month periods ended December 31, 2012, and 2011, was as follows:

Rental Expense (Dollars in millions)	Three Months Ended December 31,			
		2012		2011
(Unaudited)				
Non-cancelable real estate leases including related taxes	$	234	$	238
Facilities leased from GSA* subject to 120-day cancellation		9		10
Equipment and other short-term rentals		36		45
Total Rental Expense	$	279	$	293

*General Services Administration

Capital Commitments

At December 31, 2012, commitments to acquire capital assets were $546 million, compared to $644 million at September 30, 2012, as summarized in the following table:

Capital Commitments (Dollars in millions)	As of			
		December 31, 2012		September 30, 2012
		(Unaudited)		(Audited)
Mail Processing Equipment	$	265	$	281
Building Improvements, Construction, and Building Purchase		241		301
Postal Support Equipment		35		56
Vehicles		5		6
Total Capital Commitments	$	546	$	644

Note 6 – Contingent Liabilities

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

Each quarter, significant new claims and litigation are evaluated for the probability of an adverse outcome. If the claim is deemed probable of an unfavorable outcome and the amount of the potential resolution is reasonably estimable, a liability for the loss is recorded. Each quarter, any pre-existing claims and litigation are reviewed and adjusted for resolutions or revisions to prior estimates. This evaluation of cases resulted in a net increase of $43 million to the liability for the three months ended December 31, 2012, as compared to prior year end. The table summarizes contingent liabilities provided for in the Postal Service's financial statements as of the dates indicated.

Contingent Liabilities	As of			
(Dollars in millions)		December 31, 2012		September 30, 2012
		(Unaudited)		(Audited)
Labor - Employment	$	773	$	722
Environmental		48		48
Tort		35		43
Total Contingent Liabilities	$	856	$	813

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

Based on currently available information, adequate provision has been made for probable losses arising from claims and suits. The current portion of this liability of $68 million at December 31, 2012, and $61 million as of September 30, 2012, is included on the Balance Sheets in "Trade payables and accrued expenses". The long-term portion of this liability was $788 million at December 31, 2012, and $752 million at September 30, 2012, and is included on the Balance Sheets in "Contingent liabilities and other".

In addition to the amounts accrued in the financial statements, the Postal Service also has claims and lawsuits which it deems reasonably possible of an unfavorable outcome which range from $325 million to $450 million at December 31, 2012. No provisions for these reasonably possible losses are accrued or included in the financial statements.

Note 7 – Retirement Programs

Employees participate in one of three federal government pension programs based on the starting date of their employment with the federal government. Employee and employer contributions are made to the Civil Service Retirement System (CSRS), the Dual Civil Service Retirement System/Social Security (Dual CSRS), or the Federal Employees Retirement System (FERS), all of which are administered by the OPM. As government-sponsored benefit plans, the CSRS, Dual CSRS and FERS are not subject to the provisions of the *Employee Retirement Income Security Act of 1974*, as amended. Employees may also participate in the Thrift Savings Plan (TSP), a defined contribution retirement savings and investment plan, administered by the Federal Retirement Thrift Investment Board.

EMPLOYEE/EMPLOYER CONTRIBUTIONS

P.L. 109-435 suspends the employer contributions to CSRS that would otherwise have been required under Title 5, Section 8334(a)(1) of the United States Code until 2017. At that time, OPM will determine whether additional funding is required for the benefit of postal CSRS retirees.

As required by law, the Postal Service contribution rate was 11.9% of base salary for current FERS employees for the three months ended December 31, 2012, and 2011. The Postal Service is required to contribute to the TSP a minimum of 1% per year of the basic pay of employees covered by this system, and is also required to match a voluntary employee contribution up to 3% of the employee's basic pay, and 50% of an employee's contribution of between 3% and 5% of basic pay.

According to the most recent actuarial estimate received from OPM, the Postal Service had overfunded its FERS obligations by $2.6 billion at September 30, 2011, the latest actual data available. The reduction in the estimated surplus from amounts previously reported resulted primarily from changes to government-wide economic and demographic assumptions made by OPM, as well as actual fiscal year 2011 experience. OPM's most recent calculation shows that the FERS surplus was projected to grow to approximately $3.0 billion by September 30, 2012. The Office of Inspector General has reported that if Postal Service-specific assumptions and demographics are used to calculate the FERS liability, rather than government-wide averages, the overfunding amount would be substantially greater.

Retirement expense was $1,481 million and $1,483 million for the three months ended December 31, 2012, and 2011, respectively. Retirement expense is recorded in "Compensation and benefits" in the Statements of Operations, and includes the costs of FERS, TSP and Social Security.

Note 8 – Health Benefits Programs

CURRENT EMPLOYEES

Substantially all career employees are covered by the Federal Employees' Health Benefits Program (FEHBP). This plan covers both active and retired employees. Health care benefits are available to all participants who meet certain eligibility requirements. In addition to administering the program, OPM allocates the cost of FEHBP to the various participating government agency employers. The Postal Service cannot direct the costs, benefits, or funding requirements of the plan and, therefore, accounts for program expenses using multiemployer plan accounting rules. Contributions to the plan are recorded as an expense in the period in which the contribution is due. The portion of the premium cost paid by the Postal Service for most active employees is determined through agreements with our unions.

Employees paid approximately 22% of the premium costs in both the three months ended December 31, 2012, and in the three months ended December 31, 2011. Postal Service employee healthcare expense was $1,286 million, and $1,307 million in the three months ended December 31, 2012, and 2011, respectively. These expenses are included in "Compensation and benefits" in the Statement of Operations.

RETIREES

Employees who participate in the FEHBP for the five years immediately preceding their retirement may participate in the FEHBP during their retirement. The Postal Service is required to pay the employer's share of health insurance premiums for all retired postal employees and their survivors who participate in the FEHBP and who retire on or after July 1, 1971. The employer's share of premium costs for retirees (and their survivors) is set by law and is not subject to negotiation with the unions. Costs attributable to federal civil service before July 1, 1971, are not paid by the Postal Service. As discussed below, the Postal Service is required to prefund retiree health benefits beginning in 2007, by depositing funds into the PSRHBF each year through 2016. No other agency that participates in FEHBP is required to prefund retiree health benefits for their employees.

In 2006, P.L. 109-435 created the PSRHBF, which is held by the U.S. Treasury and controlled by OPM, but funded by the Postal Service. P.L. 109-435 established a ten-year schedule of Postal Service prefunding payments of between $5.4 and $5.8 billion per year. However, the 2009 scheduled prefunding payment was decreased from $5.4 billion to $1.4 billion due to the enactment of P.L. 111-68. In addition, the required PSRHBF payment of $5.5 billion originally scheduled to be due by September 30, 2011, was ultimately rescheduled to be due no later than August 1, 2012. As a result, the total required PSRHBF payments in 2012 were $11.1 billion: $5.5 billion due by August 1, 2012, and $5.6 billion due by September 30, 2012. The Postal Service was forced to default on the combined $11.1 billion due in 2012 because it had insufficient funds to make either of these payments. The full $11.1 billion is recorded as a current liability in “Retiree Health Benefits” on the December 31, 2012, and September 30, 2012 Balance Sheets.

Current law obligates the Postal Service to make additional payments of $5.6 billion in 2013, $5.7 billion in 2014 and 2015, and $5.8 billion in 2016, each due by September 30 of each respective year. Although P.L. 109-435 dictates the annual prefunding requirements through 2016, these amounts and the timing of funding could be changed at any time with enactment of a new law or an amendment of existing law. To date, no law changes have addressed these required payments. However, given its low levels of liquidity, the Postal Service will likely be forced to default on these prepayments in order to ensure that it continues to be able to fulfill its other statutory obligations, including the obligation to provide universal mail service to the nation (as discussed in Note 2, Liquidity). P.L. 109-435, the statutory requirement establishing the payment schedule, contains no provisions addressing a payment default.

At December 31, 2012, scheduled prefunding payments to the PSRHBF are:

PSRHBF Commitment (Dollars in millions)		**P.L. 109-435 Requirement**
2013 *	**$**	**16,700**
2014		**5,700**
2015		**5,700**
2016		**5,800**
2017		**-**
Total PSRHBF Commitment	**$**	**33,900**

* In addition to the $5.6 billion required under P.L. 109-435 due by September 30, 2013, this total includes $5.5 billion which was due by August 1, 2012, as well as $5.6 billion which was due by September 30, 2012. They are included here because the Postal Service defaulted on both of the 2012 payments due to insufficient funds. These latter contributions totaling $11.1 billion were expensed in 2012.

These annual prefunding payments are in addition to the regularly allocated cost of premiums for current retirees, which continue to be payable through 2016. The law requires that, not later than 2017, OPM will perform an actuarial valuation to determine if additional payments into the PSRHBF are required. If required, OPM will design an amortization schedule to fully fund any remaining liability by 2056. Starting in 2017, the Postal Service’s share of the health insurance premiums for current and future Postal Service retirees will be paid from the PSRHBF. Also, beginning in 2017, the Postal Service will fund the actuarially determined normal cost attributable to that year’s service for employees who will retire in the future. The Postal Service did not make any prefunding payments in 2012, or 2011, but paid $5.5 billion into the fund in 2010. At September 30, 2012, the balance in the PSRHBF was $45.7 billion. This amount represents 49% of the total OPM calculated accumulated health benefit retirement obligation of $93.6 billion as of September 30, 2012, the latest date for which data is available.

The Postal Service has contributed $38 billion to the PSRHBF since inception. These funds, which are invested by OPM, earn interest at rates between 2% and 5%.

Retiree Health Benefits		Three Months Ended December 31,		
(Dollars in millions)		2012		2011
(Unaudited)				
Employer Premium Expense	$	678	$	630
P.L. 109-435 Payment to PSRHBF		1,400		3,050
Total Retiree Health Benefits Expense	$	2,078	$	3,680

Total retiree health benefits expense was $2,078 million, and $3,680 million for the three months ended December 31, 2012, and 2011, respectively. These costs which are reflected as "Retiree health benefits" in the Statement of Operations, consists of payments to OPM for the Postal Service's share of FEHBP retiree premiums currently being paid, plus required prefunding payments to the PSRHBF for current employees who will retire in the future.

The employer premium expense for retiree health benefits for the three months ended December 31, 2012, and 2011, was $678 million and $630 million, respectively.

The Postal Service recognized $1,400 million and $3,050 million of PSRHBF expense for the three months ended December 31, 2012, and 2011, respectively. Because the amounts to be paid into the PSRHBF are set by legislation, the Postal Service retiree health expense may represent more or less than the full cost of the benefits earned by Postal Service employees.

Note 9 – Workers' Compensation

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

An estimation model that combines four generally accepted actuarial valuation techniques is used to project future claim payments based upon currently open claims and past claim payment experience. A liability is recorded for the present value of estimated future payments to postal employees, or their qualified survivors, who have been injured through the end of the reporting period. The estimated total cost of a claim is based on the date of the injury, pattern of historical payments, frequency or severity of the claim-related injury or injuries, and the expected trend in future costs. The Postal Service uses the average rate of medical inflation experienced by its workers' compensation claimants over the past five years as an estimate for future medical inflation. The liability for claims arising more than ten years ago is determined by an independent actuary.
The FECA benefit structure is often superior to benefits available under normal federal retirement, and these more lucrative payments will, in some cases, be for the rest of the lives of the claimants.

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

The estimation of the liability is highly sensitive to changes in inflation and discount rates. An increase of 1% in the discount rate would decrease the December 31, 2012 liability and Quarter I, 2013 expense by approximately $1.8 billion. A decrease of 1% in the discount rate would increase the December 31, 2012 liability and Quarter I, 2013 expense by approximately $2.3 billion.

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

Workers' Compensation Liability Inflation and Discount Rates	Quarter Ended December 31, 2012	September 30, 2012	December 31, 2011	September 30, 2011
(Unaudited)				
Compensation Claims Liability:				
Discount Rate	2.3%	2.1%	2.3%	2.3%
Wage inflation	2.9%	2.9%	2.9%	2.9%
Medical Claims Liability:				
Discount Rate	2.3%	2.2%	2.3%	2.4%
Medical Inflation	8.9%	8.9%	8.6%	8.6%

At December 31, 2012, the present value of the liability for future workers' compensation payments was $16,537 million, compared to $17,567 million at September 30, 2012, a decrease of $1,030 million. The current portion of the 2013 liability was $1,341 million at December 31, 2012, compared to $1,337 million at September 30, 2012, an increase of $4 million. These amounts are accrued under "Workers' compensation costs" on the Balance Sheets.

Changes in the workers' compensation liability are attributable to the combined impact of changes in the discount and inflation rates, routine changes in actuarial estimation, new compensation and medical cases, and the progression of existing cases. Workers' compensation expense, including the impact of changes in the discount rates, for the three month periods ended December 31, 2012, and 2011, was as follows:

Workers' Compensation Expense (Dollars in millions)	Three Months Ended December 31, 2012	2011
(Unaudited)		
Impact of Discount Rate Changes	$ (226)	$ 87
Actuarial Valuation of new cases and revaluation of existing cases	533	641
Subtotal	307	728
Administrative Fee	17	17
Total Workers' Compensation Expense	**$ 324**	**$ 745**

Note 10 – Fair Value Measurements

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

- Level 1 inputs include unadjusted quoted prices in active markets for identical assets or liabilities as of the balance sheet date.
- Level 2 inputs include quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, observable data, other than quoted market prices, for the asset or liability (i.e., interest rates, yield curves, etc.) and inputs that are derived from, or corroborated by, observable market data.

- Level 3 inputs include unobservable data that reflect current assumptions about the judgments and estimates that market participants would use when pricing the asset or liability. These inputs are based on the best information available, including internal data.

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

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

The carrying values and the fair values of noncurrent assets and liabilities that qualify as financial instruments in accordance with the accounting literature are as indicated in the table below. This table is presented for disclosure purposes only. The Postal Service has not recorded a charge or credit to its operations for the differences between carrying and fair values of the above assets and liabilities.

Fair Value of Long-Term Financial Assets and Liabilities (Dollars in millions)	December 31, 2012 Carrying Amount	December 31, 2012 Fair Value	September 30, 2012 Carrying Amount	September 30, 2012 Fair Value
	(Unaudited)		(Audited)	
Revenue Forgone	$ 380	$ 515	$ 385	$ 533
Total Long-Term Financial Assets	380	515	385	533
Long-Term Portion of Debt	5,500	6,214	5,500	6,290
Total Long-Term Financial Liabilities	$ 5,500	$ 6,214	$ 5,500	$ 6,290

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

Reconciliation of Fair Value of Level 3 Instruments (Dollars in millions)	(Unaudited)
Debt	
Balance at September 30, 2012	$ 6,290
New Indebtedness	-
Repayment of Debt	-
Unrecognized Gain	(76)
Balance at December 30, 2012	$ 6,214

For the quarter ended December 31, 2012, there were no significant transfers between Level 1 and Level 2 assets or liabilities.

Non-financial assets, such as property and equipment, are measured at fair value when there is an indicator of impairment or when a decision is made to dispose of an asset, and recorded at fair value only when impairment is recognized. Impairment analyses of property and equipment were performed in each quarter of 2013 and 2012. No impairment charges were recorded for the quarter ended December 31, 2012, and $27 million of impairment charges was recorded in the quarter ended December 31, 2011. See *Note 4–Property and Equipment* for details on impairments. Independent appraisals, adjusted for estimated selling costs, are used to determine the fair value of non-financial assets deemed impaired or being held for sale. Independent third party appraisals are deemed Level 2 inputs as defined above.

Note 11 – Revenue Forgone

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

For the three months ended December 31, 2012, the Postal Service recognized revenue of $9 million, including $6 million of imputed interest income from these appropriations, compared to $13 million, including $6 million of imputed interest, for the three months ended December 31, 2011.

The Postal Service has received $12 million of the combined total of $58 million due for the years 2011 and 2012. There was no impact to the Statement of Operations as a result of the shortfall in Congressional appropriations for these years because the revenue was previously recognized upon the enactment of the *Revenue Forgone Reform Act of 1993.* The impact of not fully funding these obligations in 2011 and 2012 only represents a change in the timing of the funding but not a change to the legal requirement for reimbursement. The unfunded amounts will be included as part of the 2013 and 2014 appropriations requests. For 2013, current proposed legislation does not contain a provision for funds to be paid to the Postal Service regarding these amounts due under the *Revenue Forgone Reform Act of 1993*. However, there has been no final legislation enacted regarding the 2013 appropriation requests.

The related amount of the receivable was $394 million at December 31, 2012, and $463 million at September 30, 2012. The current portion of this receivable was $14 million at December 31, 2012, and $78 million at September 30, 2012, and is recorded under "Receivables – U.S. Government" on the Balance Sheets while the noncurrent portions are shown as "Other Assets".

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

Cautionary Statements

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

Management’s Discussion and Analysis of Financial Condition and Results of Operations and other parts of this report include statements representing expectations about the United States Postal Service business and financial results. These may be affected by risks and uncertainties discussed here and in the Annual Report on Form 10-K for the year ended September 30, 2012, such as, but not limited to, effectiveness of operating initiatives; rate of electronic diversion; changes in laws and regulations; costs and delays associated with new regulations imposed by the Postal Regulatory Commission (PRC) or other regulatory bodies; the amount of required prefunding payments to the Postal Service Retiree Health Benefits Fund (PSRHBF); success in advertising and promotional efforts; changes in national and local business and economic conditions, including their impact on consumer and business confidence; fluctuations in currency exchange and interest rates; labor and other operating costs; oil, fuel, and other transportation costs; the effects of war and terrorist activities; competition, including pricing and marketing initiatives and new service offerings by our competitors; consumer preferences or perceptions concerning our service offerings; spending patterns and demographic trends; availability of qualified personnel; severe weather conditions; labor relations, particularly the results of collective bargaining; effects of legal claims; cost and deployment of capital; and changes in applicable accounting policies and practices. The foregoing list of important factors is not all-inclusive. Some of these and other factors, many of which we cannot control or influence, may cause actual results to differ materially from those currently contemplated. We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events, or otherwise. Operating results for the three month period ended December 31, 2012, are not necessarily indicative of the results to be expected for the year ending September 30, 2013. This report should be read in conjunction with the United States Postal Service Annual Report on Form 10-K for the year ended September 30, 2012. As in that report, all references to years, unless otherwise stated, refer to the fiscal year beginning October 1 and ending September 30. All references to quarters, unless otherwise noted, refer to quarters within fiscal years 2013 and 2012.

Introduction

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

We serve individual and commercial customers in the communications, distribution and delivery, advertising and retail markets throughout the nation and internationally. As a result, we have a very diverse customer base and are not dependent upon a single customer or small group of customers. No single customer represents more than 2% of operating revenue.

Prices and fees are subject to a review process by the Board and by the independent PRC.

P.L. 109-435 classifies postal services into two broad categories: Market-Dominant and Competitive "products"; however, the term "services" is often used in this document for consistency with other descriptions of "services" offered by the Postal Service. Price increases for those services classified as Market-Dominant are subject to a price cap based on the Consumer Price Index — All Urban Consumers (CPI-U). The regulations for Competitive services place no upper limit on price changes but do set a price floor. Throughout this document and in the day-to-day operation of the organization, we refer to our major service categories as the following: First-Class Mail, Standard Mail, Shipping and Packages, International, Periodicals, and Other. Most services in the First-Class Mail, Standard Mail, and Periodicals, are in the Market-Dominant category. Shipping and Package Services and International Mail, which are predominantly Competitive services, include, but are not limited to, First-Class and Standard Mail Parcels, Priority Mail, Express Mail, Parcel Select and Parcel Return Service, Bulk Standard Post, and Bulk International Mail. An average price increase of 2.6% for Market-Dominant and 9% for Competitive services went into effect January 27, 2013. This price increase did not impact revenues for the three months ended December 31, 2012.

Mailing and Shipping Services are sold through a network of nearly 32,000 postal-managed Post Offices, stations, and branches, plus thousands of contract postal units, community post offices, Village Post Offices, retail establishments that sell postage stamps and other services, and our website, *http://www.usps.com*. Mail deliveries are made to over 152 million city, rural, Post Office box, and highway delivery points. Operations are conducted primarily in the domestic market, with international sales representing approximately 5% of total revenue.

In December 2011, Oxford Strategic Consulting named USPS the best postal service within the world's top 20 largest economies for access to services, resource efficiency, and public trust after their comprehensive review of the performance of universal postal service providers. The report found that the Postal Service delivers nearly double the number of letters per employee as its closest ranking global competitor.

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

The labor force is primarily represented by the American Postal Workers Union, AFL-CIO (APWU), the National Association of Letter Carriers, AFL-CIO (NALC), the National Postal Mail Handlers Union, AFL-CIO (NPMHU), and the National Rural Letter Carriers Association (NRLCA). More than 85% of career employees are covered by collective bargaining agreements. The current contract with the APWU became effective May 23, 2011, and extends through May 20, 2015. The current NRLCA contract term is November 10, 2010, through May 20, 2015.

The NALC and NPMHU contracts expired on November 20, 2011. Following an arbitration award on January 10, 2013, a new contract between the NALC and Postal Service was finalized. The new contract is effective through May 20, 2016. The interest arbitration award included a two-year wage freeze, an increase in the allowable number of non-career employees, a lower wage scale for new career employees, and a decrease in the employer share of health insurance premiums.

An impasse in negotiations with the NPMHU resulted in interest arbitration hearings which began in 2012. These hearings remain in process as of the date of this report. We expect an award will be issued in Quarter II, 2013.

We are required by law to consult with management associations representing supervisory and managerial employees and postmasters prior to making final decisions concerning changes to pay and benefits for such employees.

We participate in federal employee benefit programs for retirement, health and workers' compensation benefits. Under P.L. 109-435, we are obligated to fully fund the employer's portion of the established health and retirement benefits of current retirees and current postal employees who have not yet retired. To accomplish this, the law established the Postal Service Retiree Health Benefits Fund (PSRHBF) and requires that we make prefunding payments of between $5.6 billion and $5.8 billion into the PSRHBF between 2013 and 2016. These amounts are in addition to the $38 billion contributed through 2010 and in addition to the premiums paid monthly for the health benefits of current retirees. No contribution was required or made to the PSRHBF in 2011, and we were forced to default on $11.1 billion of prefunding obligations during 2012. We have asked Congress to restructure the payment schedule for 2012 and future years. However, there can be no assurance that Congress will restructure any of the scheduled payments. Further, if no legislation is passed which impacts the $5.6 billion payment due by September 30, 2013; we will also be forced to default on that payment. See *Note 8 – Health Benefits Programs* for further discussions regarding the PSRHBF prefunding payments.

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

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

Critical Accounting Judgments and Estimates

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

The accounting policies deemed either the most judgmental or which involve the selection or application of alternative accounting policies, and are material to the interim financial statements, are described in *Critical Accounting Estimates* contained in *Management's Discussion and Analysis of Financial Condition and Results of Operations* of the Annual Report on Form 10-K for the year ended September 30, 2012. Management discusses the development and selection of accounting policies and estimates with the Audit and Finance Committee of the Board.

Recent Accounting Pronouncements

New Accounting Standards

There were no accounting standards issued or adopted during the three months ended December 31, 2012, that had or will have a material impact on our financial statements.

Results of Operations

Our net loss was $1,264 million for the three months ended December 31, 2012, compared to a net loss of $3,287 million for the same period last year, a decrease of $2,023 million, or 61.5% driven by large reductions in PSRHBF expense and workers' compensation expense.

Although significant efforts continue to be made to increase revenues and contain costs under management's control, the Postal Service has not been able to completely offset declining mail volume and related revenues. In addition, the accrual of the large PSRHBF prefunding requirement, continuation of six-days-per-week delivery and continued high fuel costs have adversely affected our financial results.

Key operating statistics are summarized in the following table.

Key Operating Statistics (Dollars and mail volume per day in millions)	Three Months Ended December 31, 2012		2011	
Operating Revenue	$	17,660	$	17,677
PSRHBF Expense	$	1,400	$	3,050
Net Loss	$	(1,264)	$	(3,287)
Total Mail Volume		43,493		43,561
Average Mail Volume per day		580		581

As explained further in the Revenue and Volume section, we are making efforts to offset continuing decreases in First-Class Mail revenue and volume due to the continued migration to electronic alternatives. New products, successful marketing campaigns, and growing consumer e-commerce are fueling growth in our package business. Through the introduction of new service offerings and better educational marketing information, we are showing customers new ways that the mail can be used in conjunction with current technologies. We continue to encourage mailers to try new products and services that can add value to their mail and connect with customers in a more individualized way. Products and services, such as Every Door Direct Mail, Click n' Ship, Business Connect, and ePostage, offer new ways of doing business with us. Customers are also increasingly using free package pickup during carrier route deliveries.

In the day-to-day operation of our business, we focus our attention on those costs that are controllable by us in the short-term.

Our net losses include expenses for the legally-mandated prefunding of retiree health benefits, as well as the legally-mandated participation in the federal workers' compensation program that is managed by the Department of Labor's (DOL) Office of Workers' Compensation Programs (OWCP) and governed by the Federal Employees' Compensation Act (FECA). Under FECA, workers' compensation claims cannot be settled through lump-sum payments. Rather, compensation must be paid over many years. As the Postal Service does not manage the FECA program, we have no ability to control the significant administrative costs. These factors, compounded by the cost of living adjustments (COLA) granted by Federal Law to those claims, results in substantially higher costs to the Postal Service than would likely be the case if claims management decisions were made by the Postal Service. In addition to the constraints imposed by the legally-mandated FECA program, actuarial estimations and projected cash payments that will be paid well into the future also have substantial impact on our reported workers' compensation liability. Future cash payments must be converted to present-day dollars, or discounted, by applying the current rates at which the liability could theoretically be settled. Discount rates can fluctuate significantly from period to period with changes in the economic and interest rate environment. Even a very small change in discount rates can have a large impact, as a 1% decrease in rates at December 31, 2012, would have resulted in a $2.3 billion increase of the liability. This can, and does, result in the GAAP workers' compensation expense varying significantly from our cash outlays.

Because the legislative mandates for prefunding of retiree health benefits and the participation in the FECA are not subject to management's control, we believe that analyzing operating results without the impact of certain of these charges provides a more meaningful insight into current operations. In the day-to-day operation of our business, we exclude these items from our internal financial analyses in order to direct focus onto the relevant expenses that management can control and include only those workers' compensation costs representing current year payments on behalf of postal claimants. The table below illustrates the loss from ongoing business activities when these charges are not considered, and reconciles this amount to our GAAP net loss.

Net Income before Impact of Expense Related to the Long-term Portion of Workers' Compensation and PSRHBF Expense				
	Three Months Ended December 31,			
(Dollars in millions)		2012		2011
Net Loss	**$**	**(1,264)**	**$**	**(3,287)**
Impact of:				
Expense Related to the Long-term Portion of Workers' Compensation		**8**		**390**
PSRHBF expense		**1,400**		**3,050**
Net Income before Impact of Expense Related to Long-term Portion of Workers' Compensation and PSRHBF Expense	**$**	**144**	**$**	**153**

Without the impact of these non-controllable factors, net income would have been $144 million for the quarter ended December 31, 2012, compared to a net income of $153 million for the quarter ended December 31, 2011.

For the three months ended December 31, 2012, operating revenues were $17,660 million, a decrease of $17 million, or less than 1%, compared to the same period last year. Shipping and Packages revenue of $3,400 million increased $154 million, or 4.7%, compared with the three months ended December 31, 2011. Shipping and Packages volume was 1,009 million pieces in Quarter I, 2013, an increase of 39 million pieces, or 4.0%, over the same period in 2012. Higher consumer spending, increased e-commerce retail sales, and increased marketing efforts were responsible for the growth in Shipping and Packages revenue and volume during the three months ended December 31, 2012.

First-Class Mail and Standard Mail account for nearly 70% of total revenues. Revenue from First-Class Mail was $7,507 million and $7,744 million in the three months ended December 31, 2012, and 2011, respectively. This represents a 3.1% decrease, consistent with the decrease in volume of 834 million pieces, or 4.5%, over the same period. Standard Mail revenue of $4,633 million increased 3.1% on a volume increase of 3.6%.

Operating expenses were $18,880 million for the three months ended December 31, 2012, compared to $20,923 million for the same period last year, a decrease of $2,043 million, or 9.8%.

Operating Expenses				
	Three Months Ended December 31,			
(Dollars in millions)		2012		2011
Compensation and Benefits	$	12,467	$	12,486
Retiree Health Benefit Premiums		678		630
PSRHBF Prefunding		1,400		3,050
Workers' Compensation		324		745
Transportation		1,839		1,766
Other Expenses		2,172		2,246
Total Operating Expenses	$	18,880	$	20,923

For the three months ended December 31, 2012, compensation and benefits expense decreased by $19 million, or 0.2%, compared to the same period last year, as work hours decreased by approximately one million. Workers' compensation expenses were $324 million for the three months ended December 31, 2012, compared to $745 million for the same period ended December 31, 2011. The $421 million, or 56.5%, decrease was driven primarily by the impact of discount rate changes that occurred in Quarter I, 2013. Transportation expenses increased by $73 million, or 4.1%, due to rising fuel costs and expenses related to contracted transportation services. Other expenses decreased by $74 million, or 3.3%, for the three months ended December 31, 2012 as compared to the same period last year.

The large decrease in total operating expenses reflects the fact that in 2013, we are accruing amounts for only one legally required PSRHBF prefunding payment. In contrast, in 2012 we were accruing amounts related to two legally required payments: one payment of $5.5 billion which was due by August 1, 2012 and one payment of $5.6 billion due by September 30, 2012. As described in *Note 8 – Health Benefits Programs*, we defaulted on both of these payments in 2012 because we did not have sufficient funds available to meet these obligations. In addition, we have advised the Administration and Congress that, absent legislative change, we do not see any means to satisfy future payment requirements under the PSRHBF, including the payment of $5.6 billion which is due by September 30, 2013, and is currently being expensed in the current year.

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

Revenue and Volume

Summary of Revenue and Volume Results

Revenue and volume are closely linked to the strength of the U.S. economy and changes in how our customers use the mail. Revenue growth is also constrained by laws and regulations restricting the types of products and services we can offer and by our ability to implement products and services and the speed with which we can bring them to market.

Since 2007, coinciding with the beginning of the recession, businesses and consumers have drastically shifted how they use the mail, and have embraced greater use of the internet, mobile communications and other technological platforms. This demand shift has had a significant negative impact on some of our traditional sources of revenue. Although some changes, such as an increase in the shipment of goods purchased online were positive for our business, the accelerated shift to electronic communication alternatives continues to present significant business challenges. These challenges are expected to continue for the foreseeable future.

Moreover, unlike a private-sector business, the Postal Service is restricted by law from taking certain steps, such as entering new lines of business, that might generate additional revenue to make up for some of the decline in First-Class Mail revenue. We are also constrained by a price cap imposed on First-Class Mail and Standard Mail prices, which generates almost 70% of our total revenues. As a result, under current regulations, the Postal Service cannot grow revenue sufficiently to compensate for the decline in First-Class Mail revenue.

To date, consumer spending and business investment since the end of the recession have not provided the growth stimulus necessary to boost mail volumes. Due to the long-term impact of technological change, discussed above, we do not anticipate mail volume returning to the levels which we experienced in the mid-2000s. In fact, we anticipate that First-Class Mail volume, which is our most profitable service, will continue to decrease for the foreseeable future.

As discussed in detail below, the impact of technological change has been especially pronounced on our First-Class Mail revenues which continue to decline even as new services, the growth of e-commerce, and successful marketing campaigns, have helped us grow our Shipping and Packages business. However, because Shipping and Packages presently represents less than 20% of our total revenues, these increases cannot fully offset the declines in First-Class Mail revenue and volume. Furthermore, the profit contribution for First-Class mail is much greater than that of packages. As a result, revenues from Shipping and Package Services would have to grow at a substantially higher rate than the decline in First-Class Mail revenues in order to replace the profit contribution of First-Class Mail.

Prices for Market-Dominant services, which primarily consist of First-Class Mail, Standard Mail and Periodicals, are capped at the rate of inflation and increased an average of 2.1% in January 2012. Competitive services, the majority of which are Express Mail, Priority Mail, First-Class Package Mail, and Parcel Return Services, increased in price by a weighted average of 4.6% in January 2012. Further price increases took effect in January 2013, but these increases did not impact this quarter’s results.

The following chart presents volumes for the three months ended December 31, 2012, and 2011, by each service line.

Volume by Service Line *	Three Months Ended December 31,	
(Pieces in millions)	2012	2011
First-Class Mail[1]	**17,723**	**18,557**
Standard Mail[2]	**22,622**	**21,839**
Shipping & Packages [3]	**1,009**	**970**
International	**267**	**293**
Periodicals	**1,640**	**1,728**
Other[4]	**232**	**174**
Total Volume by Service Line	**43,493**	**43,561**

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

[1] Excludes First-Class Mail Parcels.

[2] Excludes Standard Mail Parcels.

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

[4] Includes the US Postal Service's Mail and Free Mail provided to certain groups.

The following chart presents details of our revenues for the three months ended December 31, 2012, and 2011, by each service line.

Operating Revenue by Service Line *	Three Months Ended December 31,	
(Dollars in millions)	2012	2011
First-Class Mail [1]	**$ 7,507**	**$ 7,744**
Standard Mail [2]	**4,633**	**4,492**
Shipping & Packages [3]	**3,400**	**3,246**
International	**809**	**807**
Periodicals	**426**	**444**
Other[4]	**885**	**944**
Total Operating Revenue by Service Line	**$ 17,660**	**$ 17,677**

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

[1] Excludes First-Class Mail Parcels.

[2] Excludes Standard Mail Parcels.

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

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

Total operating revenue of $17,660 million during the first quarter of 2013, declined $17 million, or less than 1%, compared to total operating revenue of $17,677 million in Quarter 1, 2012. First-Class Mail and Standard Mail continue to provide the vast majority of our revenues, despite trends away from hard copy to electronic media.

First-Class Mail represents 43% of our revenues and accounts for 41% of the mail volume while Standard Mail generates 26% of revenues, but 52% of volume. Shipping and Packages generates approximately 20% of our revenues despite representing only 2% of volume.

FIRST-CLASS MAIL

First-Class Mail, our most profitable service category, had revenue of $7,507 million in the three months ended December 31, 2012, a decrease of $237 million, or 3.1%, from the same period last year. The corresponding volume decrease was 834 million pieces, or 4.5%. The most significant factor contributing to this decline was the continuing migration toward electronic communication and transactional alternatives.

STANDARD MAIL

Standard Mail revenue increased $141 million, or 3.1%, in the first quarter of 2013, compared to 2012, on a volume increase of 783 million pieces, or 3.6%. This increase is largely attributable to official and political campaign mail related to the Presidential and Congressional elections mailed during the quarter. New technology continues to help advertisers selectively target their mailings, resulting in fewer total pieces sent. Therefore, we do not anticipate that the trend observed in the first quarter of 2013 will continue.

SHIPPING AND PACKAGES

The following two tables present detail volumes and revenues for Shipping and Packages for the three months ended December 31, 2012, and 2011, by each service line.

Shipping & Packages Volume *	Three Months Ended December 31,	
(Pieces in millions)	2012	2011
Priority Mail	**233**	**233**
Parcel Select, Parcel Return & Standard Parcels	**392**	**360**
Package Services	**170**	**178**
First-Class Packages [1]	**204**	**189**
Express Mail	**10**	**10**
Total Shipping & Packages Volume	**1,009**	**970**

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

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

Shipping & Packages Revenue *				
	Three Months Ended December 31,			
(Dollars in millions)		2012		2011
Priority Mail	$	1,726	$	1,720
Parcel Select, Parcel Return & Standard Parcels		571		479
Package Services		449		450
First-Class Packages [1]		447		395
Express Mail		207		202
Total Shipping & Packages Revenue	$	3,400	$	3,246

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

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

Shipping and Packages revenue continued to show solid growth in the three months ended December 31, 2012, compared with the same period one year ago. Shipping and Package revenue increased $154 million, or 4.7%, from $3,246 million in the first quarter of 2012, to $3,400 million in the three months ended December 31, 2012. The increases are reflective of our successful efforts to gain market share and compete in the ground shipping services and "last-mile" e-commerce fulfillment markets. Additionally, the 2012 holiday season provided a surge in package volume this quarter as we took advantage of consumers' growing fondness for shopping online.

Priority Mail

Priority Mail, which represented 51% of total Shipping and Packages Service revenue, increased $6 million, or 0.3%, for the three months ended December 31, 2012, compared to the first quarter of fiscal year 2012. Priority Mail Flat Rate advertising campaigns continued to contribute to increased revenues in that category. Initially launched in May 2009, this campaign reinforces the message that the Postal Service is a convenient, simpler solution for shipping. In addition to offering "A Simpler Way to Ship", Priority Mail continues to offer a compelling value proposition, particularly for retail customers. E-commerce has grown at a higher rate than traditional retail sales, which has helped to boost Priority Mail revenues.

Parcel Services

Parcel Services totaled $571 million in revenue for the first quarter of 2013. This category includes Parcel Select revenue of $521 million, Parcel Returns revenue of $29 million, and Market-Dominant Standard Mail Parcels revenue of $21 million. This was an overall increase of $92 million, or 19.2%, compared to the same period of the prior year. These services showed strong volume growth of 9.0%, during the three months ended December 31, 2012, as we continue to capitalize on the competitive advantage we have in providing the "last mile" service. However, these packages represent one of our lowest priced services, and as a result, they provide a relatively lower level of profitability than many of our other services.

Package Services

Package Services revenue of $449 million decreased $1 million, or 0.2%, in the first quarter of 2013, compared to the same period in 2012. Volume decreased 8 million pieces, or 4.5%. This category includes Parcel Post, Bound Printed Matter, Library Mail and Media Mail weighing up to 70 pounds.

Because all services in this category are classified as Market-Dominant, price increases for these services are capped.

First-Class Packages
The First-Class Package Services category was introduced in 2012. This reliable package service offers commercial customers that ship primarily lightweight fulfillment parcels, the lowest priced package option in the marketplace. First-Class packages, which include the competitively priced First-Class Package Services, a commercial under one pound package product, and First-Class Mail Parcels, a Market-Dominant under 13 ounce package product, generated revenue of $447 million for the three months ended December 31, 2012. This was an increase of $52 million, or 13.2%, from the three month period ended December 31, 2011. Volume increased 15 million pieces, or 8.0%, in the first quarter of 2012, over the same period in 2011.

INTERNATIONAL MAIL

In the quarters ended December 31, 2012, and 2011, International Mail revenues were $809 million and $807 million, respectively, an increase of $2 million, or less than 1%.

PERIODICALS

Periodicals revenue decreased $18 million, or 4.1%, from $444 million in the first quarter of 2012, to $426 million in the first quarter of 2013. Periodicals volume decreased 88 million pieces, or 5.1%, to 1,640 million pieces in the three months ended December 31, 2012. Trends in hard-copy reading behavior and shifts of advertising away from print have been depressing this segment for years. Therefore, Periodicals are not expected to rebound as e-readers and electronic content continue to grow in popularity with the public.

OTHER

Other revenue includes Market-Dominant and Competitive ancillary services such as Certified Mail, P.O. Box services, return receipts, delivery confirmation, and shipping services. In addition, other revenue generated from miscellaneous items such as the sales of money orders, passport services, and the gain from the sale of real estate are also included in this category.

Operating Expenses – Compensation and Benefits

COMPENSATION AND BENEFITS

Compensation and benefits expense for the three months ended December 31, 2012, was $12,467 million, a $19 million, or 0.2% decrease compared to the three months ended December 31, 2011. Compensation expense increased by $11 million, or 0.1%, in the quarter ended December 31, 2012, compared to the same period last year. Health benefits expense of $1,286 million decreased $21 million, or 1.6%, and other compensation and benefit expense of $101 million decreased $7 million, or 6.5%, compared to the same period last year. For the three months ended December 31, 2012, retirement expense decreased $2 million, or 0.1%, compared to the same period last year.

Compensation and Benefits Expense	Three Months Ended December 31,	
(Dollars in millions)	2012	2011
Compensation	$ 9,599	$ 9,588
Retirement	1,481	1,483
Health Benefits	1,286	1,307
Other	101	108
Total Compensation & Benefits	$ 12,467	$ 12,486

COMPENSATION

Compensation expense of $9,599 million for the three months ended December 31, 2012, was a net $11 million, or 0.1%, greater than for the three months ended December 31, 2011. This increase was partially driven by a $92 million expense related to a separation incentive offer in the amount of $15,000 which was irrevocably accepted by approximately 6,000 APWU workers by December 31, 2012, who will voluntarily separate from the Postal Service, mostly through early retirements. In addition, we expect to recognize additional expense during the three months ending March 31, 2013 related to another approximately 16,500 employees who are already retirement eligible and indicated their intention to take the incentive however this group had the option until January 31, 2013 to revoke accepting the incentive and remain with the Postal Service. These early separations and retirements of employees allow us to better manage our future staffing and decrease ongoing compensation and benefits expenses. This is discussed further in the employee workforce section that follows.

Excluding the impact of the amounts related to incentive offer, compensation would have decreased by $81 million, or 0.8% for the three months ended December 31, 2012 compared to the same period last year. The decrease mostly resulted from a one million hour reduction in work hours as well as the increased utilization of non-career employees, which facilitate the realignment of staffing and workload levels and the reduction of costs. These benefits were partially offset by the increased use of over time and a 1% pay increase effective November 17, 2012 for our APWU and NRLCA employees who represent approximately 50% of our workforce.

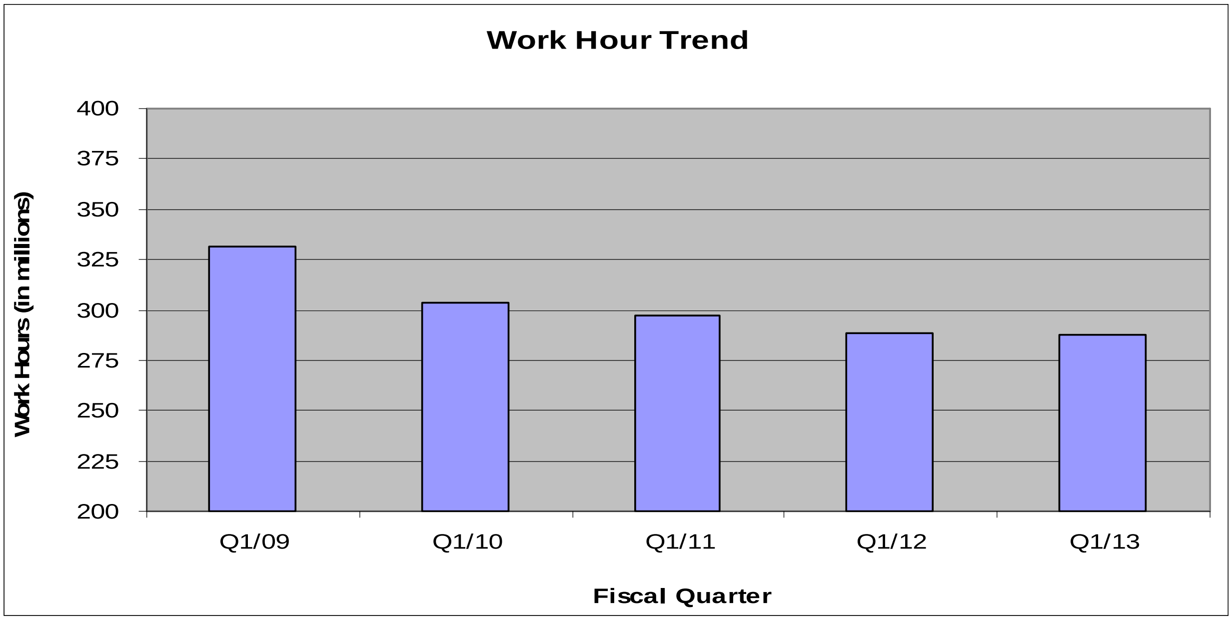
WORK HOURS

The Postal Service reduced work hours in the quarter ended December 31, 2012, by approximately 1 million hours, or 0.3%, compared to the same period last year. We achieved this decrease even with a 4.0% volume increase, compared to the same period last year, for Shipping and Packages – our products with the highest levels of workload.

Work Hours	Three Months Ended December 31,	
(Hours in Thousands)	2012	2011
City Delivery	100,607	99,799
Mail Processing	55,892	56,936
Customer Services Operations	36,513	37,526
Rural Delivery	44,400	44,745
Postmasters	14,547	14,278
Other, including Retail, Plant, Vehicle Services, Operational, Support, & Administration	35,747	35,410
Total	287,706	288,694

Customer service operations decreased 1 million work hours as modified window hours took effect in many post office locations. Conversely, city delivery hours increased due to the increased package volume created by the holiday mailing season. Although not as significant this quarter, primarily due to the growth in our package business, work hour reductions have been the single largest contributor to the ongoing achievement of savings targets. Since 2000, we have increased our efficiency and removed a cumulative total of 490 million work hours from our cost base. At our current average hourly compensation and benefit rate, this equates to annual savings of approximately $21 billion.

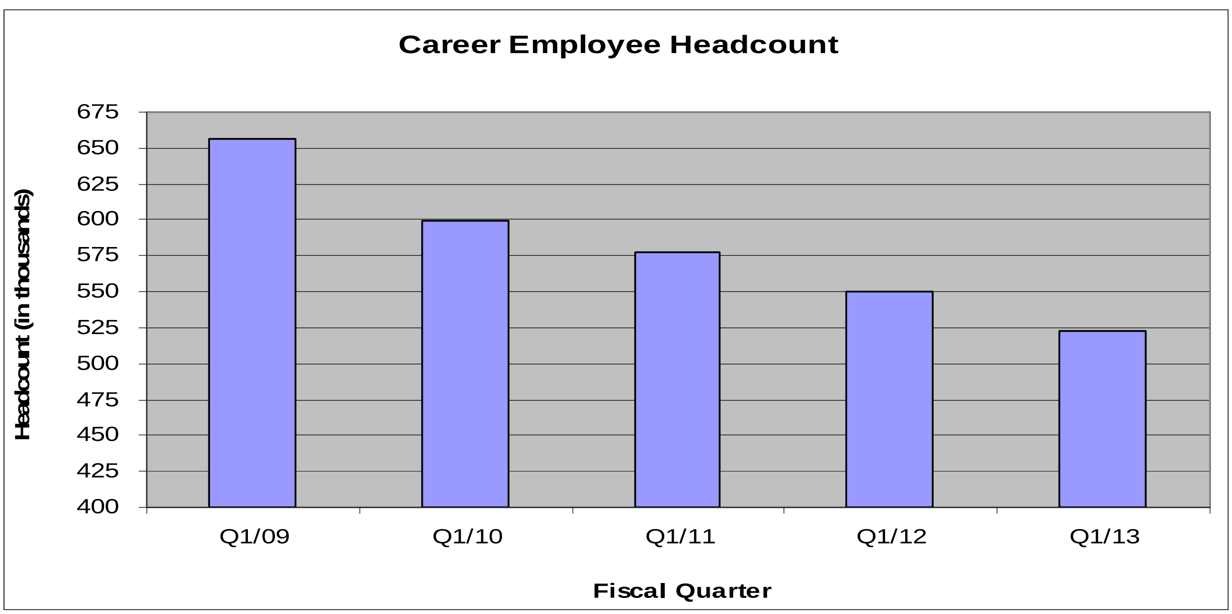
The following chart illustrates our work hour usage in the first quarter of each year since 2009 which shows that year over year work hours have steadily declined.



EMPLOYEE WORKFORCE

The total number of employees at December 31, 2012, was approximately 637,500, of which approximately 523,000 were career employees. For the three months ended December 31, 2012, the number of career employees decreased by 5,600, and has declined by approximately 27,000 since December 31, 2011. There has been a cumulative reduction of approximately 265,000, or one third, of our career employees from the total of approximately 788,000 as of September 30, 2000. These reductions have been accomplished primarily through attrition and separation incentives to retire or resign.

The following graph depicts the number of Postal Service career employees as of the first quarter each year since 2009.



In addition to improvements in service, the Postal Service continues to aggressively pursue strategies within its control to increase efficiency and achieve significant cost savings. These measures include consolidating the mail processing, retail, and delivery networks in order to better align them with mail volumes and reduce workforce costs. During 2012, the Postal Service announced detailed plans to implement these strategies. Many implementation activities were temporarily suspended during the election and holiday mailing seasons, but these actions have now resumed. These activities include the consolidation of a number of mail processing and distribution locations and the rescheduling of transportation routes and changes to staffing and hours of operation of some Post Offices. The intent of these actions is to deliver the appropriate levels of service to communities throughout America in the most cost-effective manner as possible. On January 14, 2013, the Postal Service Board of Governors directed management to accelerate cost reductions in order to strengthen Postal Service finances.

To reduce the impact on existing employees, voluntary separation incentives are periodically offered. In October 2012, the USPS offered a voluntary early retirement (VER) and special incentive opportunity to approximately 187,000 employees represented by the American Postal Workers Union (APWU). The total incentive amount is $15,000 which is to be paid in two installments: $10,000 on May 24, 2013, and $5,000 on May 23, 2014. For those who elect to participate in this incentive, separation will be effective no later than February 28, 2013. Although the cash payments will occur in future periods, the expense related to this offer was or will be recorded in compliance with GAAP in Quarter I, or Quarter II, 2013, depending on the employee's ability to revoke their decision prior to the selected separation date. For the three months ended December 31, 2012, we recognized expense of $92 million related to the irrevocable acceptance of the incentive by approximately 6,000 employees. We expect to recognize additional expense related to approximately 16,500 remaining employees who have a revocable option to accept the incentive during the three months ending March 31, 2013.

During 2012, two voluntary incentives were offered: one incentive of $20,000 was accepted by approximately 4,275 postmasters and one incentive of $15,000 was accepted by approximately 2,925 mail handlers represented by the NPMHU. Those who elected to take this incentive left the Postal Service in 2012. The full amount of these 2012 incentive offerings, approximately $135 million, was recorded as an expense in Quarter IV, 2012, although the cash payments are to be paid in Quarter I, 2013, and Quarter I, 2014.

RETIREMENT AND HEALTH BENEFITS EXPENSE– CURRENT EMPLOYEES

Retirement expense was $1,481 million for the three months ended December 31, 2012, compared to $1,483 million for the same period last year, a decrease of $2 million, or 0.1%, while health benefits expense of $1,286 million decreased $21 million, or 1.6%, compared to the same period last year.

The Postal Service's share of the health care premiums for our employees of $1,286 million represents 78% of the total health care premium cost for the three months ended December 31, 2012, compared to $1,307 million, or 78%, for the three months ended December 31, 2011. The decrease in health benefits expense was driven by a reduction in career employee headcount of approximately 27,000, or 5.0%, compared to the same period last year. However, the benefit of the lower number of employees was offset by a 3.4% increase in the average health care cost per employee due to rising health care premiums.

On October 16, 2012, and subsequently updated on December 4, 2012, the OIG published its report, *Causes of the Postal Service FERS Surplus*. Based on information provided by the Hay Group, an independent actuarial firm with Postal Service expertise, the OIG found that, if Postal Service-specific experience and demographic characteristics are used to estimate the FERS pension liability, the OPM-estimated projected surplus would increase significantly.

The OIG report explains that the Postal Service is paying more than its fair share into the Federal Employees Retirement System mainly because OPM utilizes government-wide salary increase assumptions to estimate the Postal Service's obligation. Like other agencies, the Postal Service and its employees currently contribute a total of 12.7% of payroll into FERS. But from 2001 through 2010, OPM assumed average government-wide salary growth of 4.11% per year, yet the actual increases received by the Postal Service's unionized workforce was considerably lower, ranging from 2.77% to 3.41% annually.

In addition, more than 70% of those employees had already reached the top of their pay scales, increasing the likelihood that current assumptions "overstate future salary growth" according to the OIG.

According to the most recent estimate received from OPM, the FERS surplus was projected to grow to approximately $3.0 billion by September 30, 2012. We believe that OPM should calculate FERS liabilities using Postal Service-specific assumptions and demographics as these assumptions would more accurately reflect a lower cost of our future pension obligations and in turn increase the overfunded amount. We continue to seek Congressional legislation facilitating a refund of the overfunded balance.

Operating Expenses – Retiree Health Benefits

P.L. 109-435 required the Postal Service to pay into the newly-created PSRHBF, $55.8 billion in 10 annual installments through 2016. While P.L. 109-435 dictates the amounts and timing of payments, the amounts to be paid and the timing of the payments can be rescheduled at any time with the passage of a new law, or amendment of the existing law.

As previously reported in our Annual Report on Form 10-K for the year ended September 30, 2012, we defaulted on the legally required $11.1 billion of PSRHBF payments due in 2012. The full $11.1 billion is recorded as a current liability in "Retiree health benefits" on the December 31, 2012 Balance Sheets. In accordance with GAAP, we are also accruing the $5.6 billion payment due by September 30, 2013, in equal amounts throughout the year. Absent legislative change, we see no current means to satisfy the future payment of $5.6 billion due by September 30, 2013, and we will be forced to default when that payment becomes due.

Current law also obligates us to make additional payments of $5.7 billion in 2014 and 2015, and $5.8 billion in 2016, each due by September 30 of each respective year. Although the 2009 scheduled payment amount was changed and the 2011 scheduled payment was rescheduled subsequent to the passage of P.L. 109-435, no law changes have addressed the original prefunding requirements for 2013 to 2016. However, given the low levels of our cash resources, we may be forced to default on these prefunding payments and prioritize payments to our employees and our suppliers, in order to ensure that we will continue to be able to fulfill our other statutory obligations, including our obligation to provide universal mail service to the nation (as discussed in Note 2*, Liquidity,* in the Notes to the Financial Statements)*.* The statutory requirement establishing the payment schedule (P.L. 109-435) contains no provisions addressing a payment default. As of February 8, 2013, no penalties or adverse consequences have resulted.

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

Under P.L. 109-435, we pay the premiums for postal retirees participating in FEHBP, and we continue to expense these payments as they become due, at a cost of $678 million for Quarter I, 2013. The major drivers of retiree health benefits premium costs are the number of retirees and survivors on the rolls, the mix of plans selected by retirees, the premium costs of those plans, and the apportionment of premium costs to the federal government for retiree service prior to 1971.

The components of retiree health benefits expense for the three month periods ended December 31, 2012, and 2011, are as follows:

Retiree Health Benefits	Three Months Ended December 31,	
(Dollars in millions)	2012	2011
Employer Premium Expense	$ 678	$ 630
P.L. 109-435 Payment to PSRHBF	1,400	3,050
Total Retiree Health Benefits Expense	$ 2,078	$ 3,680

Note that, while no PSRHBF prepayments were made during the first three months of the year the expense has been accrued. Expenses for the three months ended December 31, 2012, for retiree health benefits employer premiums increased $48 million, or 7.6%, from the same period last year. The major drivers of retiree health benefit employer premium expense are the number of current participants on the rolls and premium costs of the plans they select. As of December 31, 2012, there were approximately 475,000 participants, a net increase of approximately 6,000 since December 31, 2011. In addition to the growth in the number of plan participants, retiree health benefit premium expense also increased due to an increase in the cost of premiums.

Operating Expenses – Workers' Compensation

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

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

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

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

The estimation of the liability is highly sensitive to changes in inflation and discount rates. An increase of 1% in the discount rate would decrease the December 31, 2012 liability and Quarter I, 2013 expense by approximately $1.8 billion. A decrease of 1% in the discount rate would increase the December 31, 2012 liability and Quarter I, 2013 expense by $2.3 billion.

At December 31, 2012, the present value of the liability for future workers' compensation payments was $16,537 million, compared to $17,567 million at September 30, 2012, a decrease of $1,030 million. The current portion of the 2013 liability was $1,341 million at December 31, 2012, compared to $1,337 million at September 30, 2012.

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

Workers' Compensation Liability Inflation and Discount Rates	Quarter Ended December 31, 2012	September 30, 2012	December 31, 2011	September 30, 2011
Compensation Claims Liability:				
Discount Rate	2.3%	2.1%	2.3%	2.3%
Wage inflation	2.9%	2.9%	2.9%	2.9%
Medical Claims Liability:				
Discount Rate	2.3%	2.2%	2.3%	2.4%
Medical Inflation	8.9%	8.9%	8.6%	8.6%

Changes in the workers' compensation liability are attributable to the combined impact of changes in the discount and inflation rates, routine changes in actuarial estimation, new compensation and medical cases, and the progression of existing cases. Workers' compensation expense, including the impact of changes in the discount rates, for the three month periods ended December 31, 2012, and 2011, was as follows:

Workers' Compensation Expense (Dollars in millions)	Three Months Ended December 31, 2012	2011
Impact of Discount Rate Changes	$ (226)	$ 87
Actuarial valuation of new cases and revaluation of existing cases	533	641
Subtotal	307	728
Administrative Fee	17	17
Total Workers' Compensation Expense	$ 324	$ 745

On a quarterly basis, changes in the number of claims and amounts paid are highly volatile and depend on a number of factors including, but not limited to, the following: the number, timing and severity of injuries; the number of new claims and closed claims within the period; and the amount and timing of payments made by the OWCP on our behalf. Medical and compensation claims payments fluctuate significantly from quarter to quarter so the change in the number of paid medical and compensation claims for any quarter compared to the same period last year may not necessarily be representative of the results to be expected for the full year. In the three months ended December 31, 2012, we experienced a $46 million, or 19.1%, decrease in compensation claim payments. For the three months ended December 31, 2012, there was an $8 million, or 7.4%, increase in medical claims.

As noted above, we are legally-mandated to participate in the federal workers' compensation program that is managed by the Department of Labor's (DOL) Office of Workers' Compensation Programs (OWCP) and governed by Federal Employees' Compensation Act (FECA). Under FECA, workers' compensation claims cannot be settled through lump-sum payments. Rather, compensation must be paid over many years. As the Postal Service does not manage the FECA program, we have no ability to control the significant administrative costs. These factors, compounded by the cost of living adjustments (COLA) granted by Federal Law to those claims, results in substantially higher costs to the Postal Service than would likely be the case if claims management decisions were made by the Postal Service. In addition to the constraints imposed due to the legally-mandated FECA program, actuarial estimations and projected cash payments that will be paid well into the future also have substantial impact on our reported workers' compensation liability. Future cash payments must be converted to present-day dollars, or discounted, by applying the current rates at which the liability could theoretically be settled. Discount rates can fluctuate significantly from period to period with changes in the economic and interest rate environment.

For the quarters shown, the table below highlights the potentially large differences between actual claims paid on behalf of Postal Service workers' compensation obligations compared to the total recognized workers' compensation expense that includes fluctuations in discount rates, inflation rate increases, and amounts that may not be paid until well into the future.

Workers' Compensation Expense	Three Months Ended December 31,	
(Dollars in millions)	2012	2011
Total Workers' Compensation Expense	324	745
Claims Paid on Behalf of Postal Service's Workers' Compensation Obligations	316	355
Expense Related to the Long-Term Portion of Workers' Compensation	$ 8	$ 390

Operating Expenses – Transportation

Transportation expenses are primarily comprised of highway, air, and international transportation costs. Transportation expenses for the three months ended December 31, 2012, were $1,839 million, an increase of $73 million, or 4.1%, compared to $1,766 million for the same period last year.

Transportation Expense	Three Months Ended December 31,	
(Dollars in millions)	2012	2011
Highway Transportation	$ 908	$ 894
Air Transportation	641	599
International Transportation	279	262
Other Transportation	11	11
Total Transportation Expense	$ 1,839	$ 1,766

In Quarter I, 2013, highway transportation expenses were $908 million, an increase of $14 million, or 1.6%, compared to expenses of $894 million in Quarter I, 2012. This increase is primarily attributable to increases in the cost of diesel fuel. Diesel fuel, which makes up approximately 93% of fuel purchased for highway contracts, had an average cost of $4.02 per gallon during Quarter I, 2013, compared to $3.87 per gallon in Quarter I, 2012, an increase of 3.9%.

Air transportation expenses of $641 million for the quarter ended December 31, 2012, increased by $42 million, or 7.0%, from $599 million for the same quarter last year. Similar to highway transportation, air transportation expenses were highly influenced by rising fuel prices. At the same time, however, declining volume has allowed us to partially offset some of these increases.

International transportation expenses of $279 million for the quarter ended December 31, 2012, increased $17 million, or 6.5%, compared to last year. The increase is attributable to international foreign postal transaction rates which increased $25 million, or 14.0%, for the quarter ended December 31, 2012, from the same period last year. The largest component of international transportation expense is the fee that we pay to foreign postal administrations for transportation and delivery of mail within their country. These foreign postal transaction fees represented 73% and 69% of the total international transportation expense for the three months ended December 31, 2012, and 2011, respectively.

Operating Expenses – Other Operating Expense

Other operating expenses of $2,172 million for the three months ended December 31, 2012, were $74 million, or 3.3%, less than the $2,246 million of other operating expenses for the same period last year.

Other Operating Expense (Dollars in millions)	Three Months Ended December 31, 2012	 2011
Supplies and Services	$ 547	$ 536
Depreciation and Amortization	483	545
Rent and Utilities	389	405
Vehicle Maintenance Service	253	245
Information Technology and Communications	127	138
Rural Carrier Equipment Maintenance Allowance	141	148
Other	232	229
Total Other Operating Expense	$ 2,172	$ 2,246

For the three months ended December 31, 2012, decreases in depreciation of $62 million, or 11.4%, and in rent expense of $16 million, or 4.0%, were driven by a freeze in non-essential capital spending and our overall efforts to reduce square footage of postal facilities. Rural Carrier Equipment maintenance decreased $7 million, or 4.7%, while information technology and communication expenses which decreased $11 million, or 8.0% year over year. These decreases reflect management's continued efforts to control such costs.

Other operating expense categories which experienced an increase year over year are supplies and services increasing $11 million, or 2.1%, vehicle maintenance services which increased $8 million, or 3.3%, and other which increased $3 million, or 1.3%.

Liquidity and Capital Resources

CASH FLOW ACTIVITY

Cash and cash equivalents totaled $2,912 million at December 31, 2012, compared to $2,319 million and $1,002 million at September 30, 2012, and December 31, 2011, respectively. The following table provides a summary of our cash flows for the three month periods ended December 31, 2012, and 2011:

Cash Flow Statement (Dollars in millions)	Three Months Ended December 31, 2012	 2011
Operating activities:		
Net loss	$ (1,264)	$ (3,287)
Noncash depreciation and gains on sales	486	529
Changes in assets and liabilities	1,535	2,598
Cash provided by (used by) operating activities	757	(160)
Investing activities:		
Capital expenditures, net of proceeds	(137)	(204)
Cash used by investing activities	(137)	(204)
Financing activities:		
Net change in revolving credit line	-	(97)
Other	(27)	(25)
Cash used by financing activities	(27)	(122)
Net Increase (Decrease) in Cash and Cash Equivalents	$ 593	$ (486)

Operating Activities: Operating activities generated $757 million of cash during the three months ended December 31, 2012, compared to $160 million of cash used by operating activities for the three months ended December 31, 2011, an increase of $917 million. During the three months ended December 31, 2011, a significant use of cash was the deferred payment of $911 million of FERS employer contributions that were withheld from June 2011 through September 2011. Had we not made the catch-up FERS contributions in Quarter I, 2012, to compensate for the funds not paid in 2011, operating cash flow for the three months ended December 31, 2011, would have generated $751 million.

Investing Activities: Purchases of property and equipment were $166 million for the three months ended December 31, 2012, compared to $251 million in the same period last year, a decrease of $85 million, or 33.9%, as capital spending continued to decrease in order to conserve cash. Proceeds from the sale of property and equipment were $29 million, and $47 million, for the three months ended December 31, 2012, and 2011, respectively.

Financing Activities: In addition to the cash generated by operations, we use credit lines and notes payable to the Federal Financing Bank to help fund operations. During the three months ended December 31, 2012, we issued and repaid $2,700 million in notes payable for a zero net issuance. For the same period last year, we issued and repaid $2,500 in notes payable. The revolving credit line did not change from its September 30, 2012, balance of $9,500 million. For three months ended December 31, 2011, the revolving credit line decreased $97 million.

LIQUIDITY CHALLENGES

LIQUIDITY CONCERNS

We continue to suffer from a severe lack of liquidity. Our cash was $2.9 billion and $2.3 billion as of December 31, and September 30, 2012, respectively, and we had no remaining borrowing capacity on our $15 billion debt facility (See Note 3, *Debt*, for additional information). The increase in cash balances for the quarter is largely attributable the seasonal impact of holiday mailings, along with additional revenue resulting from this year's political campaign and elections. Cash balances generally decline during the remainder of the fiscal year, as revenue is not as strong in the remaining quarters. By the end of this fiscal year, we project that our liquidity balance will be less than our average weekly expenses of $1.3 billion. This low level of available cash means that the Postal Service will not be able to make the $5.6 billion legally-mandated prefunding of retiree health benefits due by September 30, 2013. Further, this level of cash could be insufficient to support operations in the event of another significant downturn in the U.S. economy.

Through the three months ended December 31, 2012, we have suffered 5 quarters of consecutive net losses and net losses in 14 of the last 16 quarters. The net loss of $1.3 billion for the first quarter of the year included $1.4 billion of expense accrued for the legally-mandated prefunding payment for retiree health benefits. The requirement of P.L. 109-435 to prefund our retiree health benefit obligations, a requirement not shared by other federal agencies or private sector businesses, plus the precipitous drop in mail volume caused by changes in consumers' uses of mail, have been the two major factors contributing to our losses since the recession ended in 2009. Without structural change to our business model, we will continue to be negatively impacted by these factors and, absent legislative change, we anticipate continuing quarterly losses for the remainder of 2013.

The retiree health benefits prefunding requirement of $5.6 billion for 2013 is in addition to paying the employers' share of the insurance premiums for our retirees, which cost $2.6 billion in 2012. In the past six fiscal years, since the enactment of the Congressionally-mandated prefunding, we have incurred $41 billion of net losses, including $32 billion of expenses for prefunding retiree health benefits. We have paid $21 billion of cash into the PSRHBF for prefunding through 2011; however, we defaulted on $11.1 billion of prefunding obligations during 2012. Since 2006, our debt has increased by nearly $13 billion, reaching the $15 billion borrowing limit at the end of 2012.

During 2012, we were forced to default on $11.1 billion of required prefunding payments to the PSRHBF for retiree health benefits. The statutory requirement establishing the prefunding payment schedule, P.L. 109-435, contains no provisions addressing a payment default. This $11.1 billion is currently reflected as a liability in our Balance Sheets. As of the date of this report, February 8, 2013, we have suffered no penalties as a result of our inability to make these payments.

We were able to make our annual payment of approximately $1.4 billion to reimburse the DOL for workers' compensation expenses in October 2012. However, current projections indicate that we will once again have a low level of liquidity in the second half of 2013. It is expected that we will be unable to make the required $5.6 billion retiree health benefits prefunding payment due by September 30, 2013, and will continue to have no ability to borrow additional funds at that date. This cash position will continue to worsen in October 2013, when we are required to make our annual payment of approximately $1.4 billion to the DOL for workers' compensation. Absent the legislative actions by Congress that have been requested to assist us in returning to a financially stable position, this low level of liquidity will continue to exist.

In the short-term, should circumstances leave us with insufficient cash, we will be required to implement contingency plans to ensure that mail deliveries continue. These measures could require us prioritize payments to our employees and suppliers ahead of those to the Federal Government, as we have done in the past. Additionally, we continue to seek a refund of the overfunding of Federal Employees' Retirement System (FERS) as those funds would help alleviate some of our short-term liquidity risks. The Office of Personnel Management (OPM) estimates that the FERS overfunding was $3.0 billion at September 30, 2012. The Office of the Inspector General (OIG) has determined that if Postal Service specific assumptions were used to estimate the FERS obligation, rather than the government-wide averages currently used, the surplus would be greater than the amount calculated by OPM.

POSTAL ACTIONS TAKEN TO IMPROVE LIQUIDITY

We continue to aggressively pursue strategies within our control to increase efficiency and to improve its liquidity position. These measures include consolidating the mail processing, retail, and delivery networks in order to better align them with mail volumes, pursuing new revenue streams, and reducing workforce costs.

During 2012, we announced detailed plans to implement these strategies, and actions are underway to increase the productivity of the mail processing, delivery and retail networks. This requires the consolidation of a number of mail processing and distribution locations and the rescheduling of transportation routes, while continuing to deliver appropriate levels of service to communities throughout America.

On January 14, 2013, citing the fact that we cannot wait indefinitely for legislation, our Board of Governors directed management to accelerate the restructuring of our operations to further reduce costs in order to strengthen our finances. On February 6, 2013, we announced plans to transition to a new delivery schedule during the week of August 5, 2013, that includes package delivery Monday through Saturday and mail delivery Monday through Friday. We expect to generate cost savings of approximately $2 billion annually, when the change in delivery frequency is fully implemented.

We also continue to introduce new service offerings and use educational marketing information to generate new revenue and slow the migration of existing revenue streams to electronic alternatives. Major advertising campaigns promote mail as a powerful way for businesses to reach and engage their customers. However, it is not possible to achieve financial stability through revenue initiatives alone without a fundamental change in the business model.

As we implement these efficiency measures, our plans are to continue our actions to better align staffing levels with projected mail volume. This will be achieved largely through attrition, as approximately one-half of career employees are eligible for retirement or voluntary early retirement. Special Incentive and Voluntary Early Retirement (VER) offers were accepted by approximately 22,500 eligible American Postal Workers' Union (APWU) employees by January 31, 2013, 6,000 of whom were locked-in by December 31, 2013. This follows the 4,275 eligible postmasters and 2,925 eligible mail handlers, who retired or separated from the Postal Service in Quarter IV, 2012. In addition, recent contractual agreements with major postal unions allow for increased utilization of non-career employees, which will facilitate the realignment of staffing and workload levels and the reduction of costs.

Achieving significant future efficiencies and cost reductions in areas that are under our control will not be enough to return us to a position of financial viability in the long run without comprehensive changes to its business model. Accordingly, we have proposed legislative changes to Congress that are needed to provide us with the legal authority to implement certain measures to increase efficiency and produce additional cost savings. Certain parts of the plan, such as resolving the prefunding of retiree health benefits and obtaining a refund of the FERS overfunding, may be beyond the control of management because they require enactment of legislation or legislative restraint. The legislative process started anew with the 113th Congress which began in January 2013. Given the vital role that we play in the U.S. economy, management is requesting that Congress promptly take the steps needed to enact legislative changes that will enable us to return to financial stability.

A vital component of the five-year plan is the proposal that we sponsor our own health care program independent of other federal health insurance programs. A Postal Service-sponsored health care program could achieve over $7 billion of projected annual savings. The plan would allow for the elimination of the retiree health benefit prefunding obligation established in P.L. 109-435, which would save us over $5 billion annually through 2016. The plan also proposes to transfer current retirees into the Postal Service-sponsored health care program, an action that requires legislation.

MITIGATING CIRCUMSTANCES

Our status as an independent establishment of the executive branch that does not receive tax dollars for its operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With revenues of $65 billion, generated almost entirely through the sale of postage, a financially sound Postal Service is vital to American commerce. The U. S. economy benefits greatly from our organization and the many businesses that provide the printing and mailing services that support it. Disruption of the mail would cause hardships to consumers, and could cause many businesses to literally shut down. Therefore, it is unlikely that, in the event of a cash shortfall, the Federal Government would allow us to significantly curtail or cease operations.

We continue to inform the Administration, Congress, the Postal Regulatory Commission (PRC), and other stakeholders of the immediate and longer-term financial issues we face and the legislative changes that would help provide financial stability. Given the vital role we play in the U.S. economy, we are hopeful that Congress will promptly enact, and the President will sign, legislation which will mitigate our short-term financial challenges and provide us with the authority to make needed changes to ensure long-term financial stability. However, there can be no assurances that the requests to restructure the PSRHBF prefunding payment schedule, or any other legislative changes, will be made in time to impact 2013, or at all.

Contractual Obligations

Our cash flow obligations as of December 31, 2012, for 2013, and future years are scheduled in the following table.

Contractual Obligations	Payments Due by Period Ending December 31,				
(Dollars in millions)	Total	Less than 1 Year	1-3 Years	3-5 Years	After 5 Years
Debt (1)	$ 15,000	$ 6,800	$ 3,000	$ 300	$ 4,900
Interest on debt (1)	2,031	139	342	327	1,223
PSHRBF	33,900	16,700	11,400	5,800	-
Capital lease obligations	634	96	181	197	160
Operating leases	6,786	726	1,263	1,872	2,925
Capital commitments (2)	546	314	178	36	18
Purchase obligations (2)	1,675	1,557	112	6	-
Workers' compensation (3)	22,539	1,341	4,598	3,449	13,151
Employees' leave (4)	2,389	516	257	205	1,411
	$ 85,500	$ 28,189	$ 21,331	$ 12,192	$ 23,788

(1) For overnight and short-term debt, the table assumes the balance as of period end remains outstanding for all periods presented.
(2) Legally binding obligations to purchase goods or services. Capital commitments pertain to purchases of equipment, building improvements and vehicles. Purchase obligations generally pertain to items that are expensed when received or amortized over a short period of time. Capital commitments and purchase obligations are not reflected on the Balance Sheet.
(3) Assuming no new cases in future years. This amount represents the undiscounted expected workers' compensation payments. The discounted amount of $16,537 million is reflected in our Balance Sheet at December 31, 2012.
(4) Employees' leave includes annual and holiday leave.

Legal Matters and Contingent Liabilities

An estimated loss contingency is accrued in our financial statements if it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Assessing contingencies is highly subjective and requires judgments about future events. We regularly review loss contingencies to determine the adequacy of our accruals and related disclosures. The amount of the actual loss may differ significantly from these estimates. As of December 31, 2012, the material claims increased to $856 million from $813 million at September 30, 2012.

McConnell v. Donahoe: On January 14, 2010, the Equal Employment Opportunity Commission's (EEOC) Office of Federal Operations certified a class action case against the Postal Service in a matter captioned McConnell v. Donahoe. The class currently consists of all permanent rehabilitation employees and limited-duty employees who have been subjected to the National Reassessment Process (NRP) from May 5, 2006, to July 1, 2011. We used the NRP to ensure that our records were correct and that employees receiving workers' compensation benefits were placed in jobs consistent with their abilities. The case alleges violations of the Rehabilitation Act of 1973 resulting from the NRP's failure to provide a reasonable accommodation, the NRP's wrongful disclosure of medical information, the creation by the NRP of a hostile work environment, and the NRP's adverse impact on disabled employees. The class is seeking injunctive relief and damages of an uncertain amount on behalf of a yet-unidentified population of employees. If the plaintiffs were able to prove their allegations in this matter and to establish the damages they assert, then an adverse ruling could have a material adverse impact on us. However, we dispute the claims asserted in this class action case and are vigorously contesting the matter. See Note 6, *Contingent Liabilities*, in Notes to the Financial Statements for additional information.

Fair Value Measurements

As required by authoritative accounting literature, certain fair value disclosures for the three months ended December 31, 2012, are contained in the Notes to the Financial Statements. We did not recognize gains as a result of valuation measurements during Quarter I, 2013. All recognized losses have been incorporated into our financial statements as of December 31, 2012. See Note 10-*Fair Value Measurements.*

Legislative Update

The first quarter of Fiscal Year 2013 for the Postal Service encompassed the closing months of the 112th Congress. Due to fiscal cliff negotiations, Congress worked until the end of calendar year 2012. The two major pending postal reform bills, discussed in detail below, were not enacted. The 113th Congress, which was sworn in on January 3, 2013, does not carry forward any pending legislation from the 112th Congress. Postal reform legislation, previously introduced, must be drafted and reintroduced.

Appropriations and Continuing Resolutions

The Postal Service received an appropriation of $78 million, made available on October 1, 2012, for 2012 costs related to free mail for the blind and overseas voters. No funding was provided for the $29 million payment owed to the Postal Service under the *Revenue Forgone Reform Act of 1993.* Congress has yet to enact final appropriations language for 2013. Currently, most of the Federal Government is operating under P.L. 112-175, the *Continuing Appropriations Resolution, 2013,* which provides funding for government operations conducted in 2012, through March 27, 2013. Because the Postal Service does not receive any tax dollars for operating expenses, the lack of an appropriations bill has only minimal impact on Postal operations.

<u>CONGRESSIONAL POSTAL REFORM PROPOSALS</u>

The 112th Congress introduced a number of bills regarding postal reform legislation. The following is a detailed description of the two major reform bills. Although these bills expired at the end of the 112th Congress, we expect similar measures to be reintroduced in the 113th Congress.

21st CENTURY POSTAL SERVICE ACT OF 2012

On April 25, 2012, the Senate passed S. 1789, the *21st Century Postal Service Act of 2012*. S. 1789 provides for reform on a variety of issues. S. 1789 would:

- Return the current FERS overpayment to the Postal Service, along with any future surpluses. The returned surplus may be used for incentive payments for retirement, or paying the value of incentives in the form of added service credits, for employees retiring before October 1, 2015. Additionally, the returned surplus may be used to pay down debt or make other payments to federal agencies, such as the workers' compensation reimbursement to the Department of Labor (DOL).
- Requires the Postal Service to offer retirement incentives to such an extent as would reasonably be expected to result in an 18% reduction in career employees by October 1, 2015.
- Restructure the existing pre-payment schedule for the Postal Service Retiree Health Benefit Fund (PSRHBF) by cancelling the 2011 to 2017 annual payments and provide an amortized payment schedule with a prefunding goal of 80 percent of the total actuarial liability beginning September 30, 2013. Additionally, retiree health benefit premiums would be paid from the PSRHBF, rather than from Postal funds.
- Enact government-wide workers' compensation reforms.
- Prohibit the Postal Service from instituting five-day delivery for a two-year period following enactment of S. 1789, but allow for implementation after a GAO report on the financial necessity of five-day delivery and a second PRC advisory opinion.
- Modify existing procedures governing the Area Mail Processing (AMP) study process, particularly the public input process.
- Provide for other items, such as requiring an arbitrator to consider the financial condition of the Postal Service when making decisions on collective bargaining agreements, creating service standards for access to retail services, permitting the Postal Service to offer new non-postal services, and allowing for the mailing of wine, beer, and distilled spirits.

POSTAL REFORM ACT OF 2011

H.R. 2309, the *Postal Reform Act of 2011* was introduced on June 23, 2011, and provided for reform on a variety of issues. H.R. 2309 would:

- Create a Commission on Postal Reorganization (CPR), which would conduct proceedings regarding closures and discontinuances of the Postal infrastructure to achieve certain cost reduction targets in areas such as retail facilities, mail processing facilities, and area and district offices.
- Provide the Postal Service the authority to change to a five-day delivery frequency schedule after one year.
- Return the FERS overfunded surplus to the Postal Service.
- Establish a Postal Service Financial Responsibility and Management Assistance Authority, which would operate during any control period. A control period would commence whenever the Postal Service has been in default to the U.S. Treasury with respect to borrowing, for a period of 30 days. The Authority would have broad powers during such control period, including assuming all of the powers of the Postal Service Board of Governors.
- Provide guidance on other issues including: modifying collective bargaining agreements, placing limitations on postal contributions to life and health insurance programs under the Federal Employee Group Life Insurance (FEGLI) and the Federal Employees Health Benefit Program (FEHBP), modifying some postal rates, allowing the Postal Service to offer specific non-postal products and services, and making reforms in specific Postal Service contracting practices and provisions.

The full House did not act on H.R. 2309.

Item 3 – Quantitative and Qualitative Disclosures about Market Risk

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

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

See our 2012 Annual Report on Form 10-K, Financial Section Part II, Item 7A-*Quantitative and Qualitative Disclosures about Market Risk*.

Item 4 – Controls and Procedures

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

Disclosure Controls

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

We carried out an evaluation under the supervision and with the participation of management, including the Postmaster General and Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of December 31, 2012. Based upon, and as of the date of, the evaluation, the Postmaster General and Chief Financial Officer concluded that our disclosure controls and procedures were effective.

Internal Controls

There have been no changes in the Postal Service's internal controls over financial reporting during the quarter ended December 31, 2012, that have materially affected, or are reasonably likely to materially affect, the Postal Service's internal control over financial reporting.

Part II

Item 1 – Legal Proceedings

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

Item 1A – Risk Factors

There have been no material changes in risk factors from those disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the year ended September 30, 2012.

Item 4 – Mine Safety Disclosures

Not applicable to the United States Postal Service.

Item 6 – Exhibits

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

Signatures

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

United States Postal Service

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

Date: February 8, 2013

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

Date: February 8, 2013

Exhibit 31.1

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

I, Patrick R. Donahoe, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: February 8, 2013

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

Exhibit 31.2

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

I, Joseph Corbett, certify that:

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

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

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

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

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

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

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

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

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

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

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

Date: February 8, 2013

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

Exhibit 32.1

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

In connection with the Quarterly Report of the United States Postal Service (Postal Service) on Form 10-Q for the period ended December 31, 2012, (the “Report”), I, Patrick R. Donahoe, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

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

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

Dated: February 8, 2013

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

Exhibit 32.2

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

In connection with the Quarterly Report of the United States Postal Service (Postal Service) on Form 10-Q for the period ended December 31, 2012 (the “Report”),I, Joseph Corbett, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 that:

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

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

Dated: February 8, 2013

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