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

FORM 10-K

(Mark One)

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

For the fiscal year ended SEPTEMBER 30, 2017

or

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

For the transition period from ____________ to ____________

Commission file number N/A

UNITED STATES POSTAL SERVICE

(Exact name of registrant as specified in its charter)

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

475 L'Enfant Plaza, S.W.
Washington, DC 20260
(202) 268-2000

(Address and telephone number, including area code, of registrant's principal executive offices)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. Yes ☐ No ☐ Not Applicable ☑

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ☐	Accelerated filer ☐	Non-accelerated filer ☐
Smaller reporting company ☐	Emerging growth company ☐	Not Applicable ☑

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ☐

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

The aggregate market value of shares of common stock held by non-affiliates as of March 31, 2017: N/A

The number of shares of common stock outstanding as of November 14, 2017: N/A

Documents incorporated by reference: None

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UNITED STATES POSTAL SERVICE

PART I

ITEM 1. BUSINESS

In accordance with the provisions of the *Postal Reorganization Act* ("PRA"), the United States Postal Service ("Postal Service," "USPS," "we," "our" and "us") began operations on July 1, 1971, succeeding the cabinet-level Post Office Department established in 1792. The PRA established us as an "independent establishment of the executive branch of the Government of the United States" with the mandate to offer a "fundamental service" to the nation "at fair and reasonable rates." We do not receive tax dollars for operating expenses and rely solely on the sale of postage, products and services to fund our operations.

We serve retail and commercial customers in the communications, distribution and delivery, advertising and retail markets throughout the nation and internationally. As a result, we maintain a very diverse customer base and are not dependent upon a single customer or small group of customers. No single customer represented more than 5% of operating revenue for the years ended September 30, 2017, 2016 and 2015.

As an establishment of the executive branch, we align specific objectives with those of the U.S. government. We are subject to numerous federal, state and local regulatory and reporting laws, as well as environmental laws and regulations. Our governing statute is codified in Title 39 of the U.S. Code. The *Postal Accountability and Enhancement Act of 2006, Public Law 109-435* ("PAEA") made revisions to the PRA and established the Postal Regulatory Commission ("PRC"), endowing it with regulatory and oversight obligations.

We operate and manage a very extensive and integrated retail, distribution, transportation and delivery network. Although PAEA divides our services into Market-Dominant and Competitive products, we monitor revenue by mail classes and weights, and we operate as a single segment throughout the U.S., including its possessions and territories.

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

GOVERNANCE

The law requires an eleven-member Board of Governors ("Board") which generally consists of our Postmaster General, Deputy Postmaster General and nine independent governors ("Governors"). The Governors are appointed by the President of the United States ("President") with the advice and consent of the United States Senate ("Senate"). The Postmaster General is appointed by the Governors, and the Deputy Postmaster General is appointed by the Governors and the Postmaster General.

The Board is required by law to have a quorum of six members in order to take certain actions. In November 2014, while the Board still had a quorum, it issued a resolution that established a Temporary Emergency Committee of the Board ("TEC") to exercise certain powers reserved to the Board that are necessary for continuity of operations during a period in which it is unable to assemble a quorum.

Also in November 2014, the Governors issued a resolution regarding the exercise of those powers conferred by law solely to the Governors as distinguished from the full Board, which include the appointment and removal of the Postmaster General and the establishment of prices and classifications for our services. The Governors determined that their ability to exercise those powers reserved to the Governors' was not impacted by the loss of a Board quorum.

In December 2014, due to the term expiration of one Governor and Senate inaction on pending nominations, the number of sitting Board members dropped to five, thereby rendering the Board unable to assemble a quorum. The TEC has exercised its powers since that time.

We publicly announced the resolutions that established the TEC and the Governors' exercise of power reserved to them in a December 16, 2014, Federal Register notice.

On December 8, 2015, the terms of two of the remaining Governors expired, which reduced the number of sitting Board members to three, including only one Governor. On December 8, 2016, the hold-over term of our last remaining independent Governor expired. At present, the Board consists of only our Postmaster General and Deputy Postmaster General, and for the first time since we began operations as the United States Postal Service in 1971, the Board currently has no presidentially appointed Governors. On October 30, 2017, the President nominated three individuals to serve as Governors, and the process of obtaining confirmation by the Senate is in its earliest stage.

The TEC currently consists of only our Postmaster General and Deputy Postmaster General and exercises those Board powers necessary for operational continuity. The TEC will continue in existence until the Board is again able to assemble a quorum.

SERVICES

We fulfill our legal mandate to provide universal services at fair prices by offering a variety of postal services to our many customers. Our Governors approve our prices and fees, subject to a review process by the PRC. Services are sold by approximately 31,000 Postal Service-managed Post Offices, stations and branches, plus approximately 4,000 additional Contract Postal Units, Community Post Offices, Village Post Offices, and a large network of commercial outlets which sell stamps and services on our behalf and through our website www.usps.com. Mail deliveries are made to approximately 157 million city, rural, *PO Box* and highway delivery points. Operations are conducted primarily in the domestic market, with international revenue representing approximately 4% of operating revenue for the year ended September 30, 2017.

CLASSIFICATION AND PRICING

Within *First-Class Mail*, *Marketing Mail*, *Periodicals*, *International* and *Other* services, prices do not vary unreasonably by customer for the level of service provided. Although the PAEA classifies our services as Market-Dominant and Competitive "products," the term "services" is often used in this report for consistency with other descriptions of services we offer.

Periodic reclassification of services from Market-Dominant to Competitive, which requires PRC approval, is necessary to rationalize service offerings. The additional flexibility provided in Competitive services allows us to better offer services to meet customer needs, increase our business and price our services competitively within the markets in which we operate. Information regarding PRC decisions and pending dockets can be obtained on the PRC website: www.prc.gov.

Market-Dominant Services

Market-Dominant services account for approximately 70% of our annual operating revenues. Such services include, but are not limited to, *First-Class Mail*, *Marketing Mail*, *Periodicals* and certain parcel services. Price increases for these services are currently generally subject to a price cap based on the Consumer Price Index for All Urban Consumers ("CPI-U"). Our Governors approve the prices for Market-Dominant services, subject to a review process by the PRC for legal compliance.

We implemented price increases on certain Market-Dominant services that averaged 0.9% in January 2017 and 1.9% in May 2015. Also during 2017, we changed the name of our former *Standard Mail* service category and class of mail to *USPS Marketing Mail* (more commonly, *Marketing Mail*). On October 6, 2017, we filed with the PRC a notice of our intent to increase prices for certain Market-Dominant services by an average of 1.9%. On November 9, 2017, the PRC approved this plan and the increase is scheduled to go into effect on January 21, 2018.

In December 2013, the PRC ruled that we could collect a 4.3% exigent surcharge on Market-Dominant services beginning in January 2014, until such time as the surcharge produced $3.2 billion in incremental revenue, an amount the PRC determined was lost due to the Great Recession's suppression of mail volume. On July 29, 2015, the PRC authorized us to collect over $1.4 billion in additional incremental revenue from the surcharge, bringing the total allowed to just over $4.6 billion. This limit was reached on April 10, 2016, and we therefore reduced the prices of applicable Market-Dominant services on that date.

As a result of the expiration of the surcharge, we estimate that our revenue and cash flow for 2017 and 2016 were lower by approximately $2 billion and $1 billion, respectively, than what they otherwise would have been. Revenue is expected to continue to be less than it would have been had the exigent surcharge remained in place going forward.

Competitive Services

Competitive services, such as *Priority Mail*, *Priority Mail Express*, *First-Class Package Service*, *Parcel Select* and *Parcel Return Service* and some types of *International* mail, have greater pricing flexibility. Prices for Competitive services are set by our Governor(s) and reviewed by the PRC for legal compliance. By law, prices must cover "attributable costs" (meaning the postal costs attributable to such product through reliably identified causal relationships) to each service and must contribute an appropriate share of the institutional costs of the Postal Service, currently 5.5%, as determined by the PRC.

We implemented price increases on certain Competitive services that averaged 3.9% in January 2017, 9.5% in January 2016, and 3.5% in May 2015. In September 2017, we transferred a Market-Dominant service (*First-Class Package Service - Retail*, formerly *First-Class Mail Parcels*) to a Competitive service and implemented an average price increase of 9.9% on that service. On October 6, 2017, we filed with the PRC a notice of our intent to increase prices for certain Competitive services by an average of 4.1%. On November 7, 2017, the PRC approved this plan and the increase is scheduled to go into effect on January 21, 2018.

The PAEA prohibits the subsidization of Competitive services costs by Market-Dominant services revenue. The PRC reviews our price increase notices, and we are diligent to ensure that each Competitive service covers its attributable costs and contributes an appropriate share of institutional costs.

SERVICE CATEGORIES

Although we operate as a single segment, we monitor revenue by mail classes, products and shapes. Our management uses the following broad service categories to describe and report on our performance:

- **First-Class Mail** - This category encompasses the *First-Class Mail* class of mail representing letters, postcards or any flat advertisement or merchandise destined for either domestic (up to 13 ounces) or international (up to 4 pounds) delivery. *First-Class Mail* letters include postcards, correspondence, bills or statements of account and payments.

- **Marketing Mail** - This category includes advertisements and marketing packages, weighing less than 16 ounces that are not required to be sent using *First-Class Mail*. *Marketing Mail* is typically used for direct advertising to multiple delivery addresses. *Every Door Direct Mail* enables customers to prepare direct mailings without names and addresses for distribution to all business and residential customers on individual carrier routes. In January 2017, upon approval by the PRC, we changed the name of *Standard Mail* to *USPS Marketing Mail* to aid our customers in understanding what *Marketing Mail* is and how it can be used as part of the respective customers' marketing strategies.

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

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

- **Periodicals** - This category encompasses the *Periodicals* class of mail offered for newspaper, magazine and newsletter distribution. This service requires prior authorization by the Postal Service.

- **Other** - This broad category includes: *PO Box* services, which provide customers an additional method for mail delivery that is private and convenient. *Money Orders* offer customers a safe, convenient and economical method for the remittance of payments. *Money Orders* are available for amounts up to $1,000, can be purchased and cashed at most Post Offices, or can be deposited or negotiated at financial institutions. USPS Extra Services offer a variety of service enhancements that provide security, proof of delivery or loss recovery. These services include: *Certified Mail*, *Registered Mail*, *Signature Confirmation*, *Adult Signature* and insurance up to $5,000 and are available online, at Post Offices or at automated postal centers.

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

RESEARCH AND DEVELOPMENT

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

INTELLECTUAL PROPERTY

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

MARKETING

Our marketing program seeks to capitalize on our industry standing, including our existing relationships and our reputation based on our service delivery performance every day. We have adjusted to changes in customer behaviors and demands to make accessing and using postal services more convenient. We have developed innovative mobile applications which enable customers to locate a Post Office, find a ZIP Code, track packages and shop online.

Online service offerings available through www.usps.com have also enhanced the customer experience. Included in online services is *Informed Delivery*, which enables customers to preview mail, as well as manage packages scheduled to arrive, as a means of merging digital and physical mail.

Our marketing approach highlights our value, our enhanced digital technologies and the linkages between them. Additionally, we seek to maintain our name recognition through the use of media advertising, trade shows, technical seminars and direct mailings.

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

COMPETITION

A wide variety of communications media compete for the same types of transactions and communications that historically were conducted using our services. These channels include, but are not limited to, newspapers, telecommunications, television, email, social networking and electronic funds transfers. The package and express delivery businesses are highly competitive, with both national and local competitors.

The most significant competitive factor for *First-Class Mail* is the digital form of communication, including electronic mail, as well as other digital technologies such as online bill payment. For *Marketing Mail*, digital forms of advertising including digital mobile advertising, are the most significant form of competition.

The primary competitors of our Shipping and Packages services are FedEx Corporation and United Parcel Service, as well as other regional and local delivery companies and leisure carriers. Our Shipping and Packages business competes on the basis of the breadth of our service network, convenience, reliability and economy of the service provided. The growth in our Competitive service revenues over the past five years is largely attributable to three major customers.

SEASONALITY

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

EMPLOYEES

At September 30, 2017, we employed approximately 503,000 career employees and approximately 141,000 non-career employees, substantially all of whom reside in the U.S. For a more detailed discussion of items that impact our employees, see *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations*, *Results of Operations*, *Operating Expenses*.

BARGAINING AGREEMENTS

Approximately 92% of career employees are covered by collective bargaining agreements. These agreements include provisions governing work rules and provide for general wage increases, step increases and cost of living adjustments ("COLAs"), which are linked to the Consumer Price Index – Urban Wage Earners and Clerical Workers ("CPI-W"), as well as provisions that limit our ability to reduce the size of the labor force and restrict the number of non-career employees. Our 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").

By law, we must consult with management organizations representing most of our employees not covered by collective bargaining agreements. These consultations provide non-bargaining unit employees in the field with an opportunity to participate in the planning, development and implementation of certain programs and policies that affect them.

FEDERAL EMPLOYEE AND RETIREMENT BENEFIT PROGRAMS

We are required to participate in U.S. government pension and health and benefits programs for employees and retirees, including the Federal Employees Health Benefit ("FEHB") program, the Civil Service Retirement System ("CSRS") and the Federal Employees Retirement System ("FERS"). We have no control or influence over the benefits offered by these plans and we contribute to these plans as specified by law or contractual agreements with our employee unions (in the case of health benefits for most active employees).

The PAEA established the Postal Service Retiree Health Benefits Fund ("PSRHBF") in 2006. In accordance with applicable law, we are required to fully prefund retiree health benefits. Such a requirement to fully prefund retiree health benefits is not imposed on most other federal entities or private sector businesses that offer such benefits.

Since its enactment, the PSRHBF prefunding requirement has contributed significantly to our losses. As of September 30, 2017, we have contributed $20.9 billion to the PSRHBF and defaulted on additional prefunding amounts totaling $33.9 billion for the years 2012 through 2016, because we did not have sufficient funds to make the funding payments without adversely impacting our ability to continue operations. As of the date of this report, we have not incurred any penalties or negative financial consequences as a result of not making the PSRHBF prefunding payments.

In 2017, the PSRHBF began funding the Postal Service's share of retiree health benefit premiums, and we were to begin paying the "normal costs" of retiree health benefits (i.e., the present value of the estimated retiree health benefits attributable to active employees' current year of service) into the PSRHBF, as well as an amortization payment of our unfunded liability. For the year ended September 30, 2017, the amounts billed for normal costs and amortizations were $3.3 billion and $955 million, respectively. We did not make these 2017 payments in order to preserve liquidity and to ensure that our ability to fulfill our primary universal service mission was not placed at undue risk.

Our retirement plan obligations for FERS consist of FERS normal costs, the employer portion of TSP contributions, Social Security and costs for the unfunded retirement benefits for FERS. We incurred a FERS unfunded liability expense of $917 million for the year ended September 30, 2017. Although we made all required payments for FERS normal cost, the TSP and Social Security, we did not make the required lump sum payment for FERS unfunded retirement benefits, in order to preserve liquidity. As of the date of this report, we have not incurred any penalties or negative financial consequences as a result of not making this payment.

In addition, in accordance with PAEA, in 2017 we were required begin to making annual payments to amortize the unfunded CSRS liability, and we incurred a CSRS unfunded liability expense of $1.7 billion for the year ended September 30, 2017.

We did not make the required lump sum payment for the CSRS unfunded retirement benefits, in order to preserve liquidity. As of the date of this report, we have not incurred any penalties or negative financial consequences as a result of not making this payment.

We are legally-mandated to participate in the federal workers' compensation program that is managed by the Department of Labor's ("DOL") Office of Workers' Compensation Programs ("OWCP") and governed by the *Federal Employees' Compensation Act* ("FECA").

OVERSIGHT AND REGULATION

As discussed throughout this report, we are subject to oversight by the United States Congress ("Congress") and regulation by the PRC and other government agencies. In addition to Senate confirmation of our Governors, Congress significantly influences how we conduct our business and operations through passage of laws. For example, unless and until new laws become effective, we are legally bound by annual *Financial Services and General Government* appropriations legislation, which is part of the larger U.S. government's budget and spending process each fiscal year for specific U.S. government departments, agencies and programs. Among other restrictions, such legislation requires us to maintain a six-day delivery schedule. We are also bound by Postal Service-specific legislation, such as the PAEA, which impacts our financial performance and restricts our competitiveness by limiting our ability to grow our business, price our services and constrain our expenses. For a more detailed explanation, see *Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations*, *Legislative Update*.

ENVIRONMENTAL MATTERS

Although we are required to comply with various federal, state or local environmental laws and regulations, none of these has had a material impact on our financial results or competitive position, or resulted in material capital expenditures. However, the effect of possible future environmental legislation or regulations on operations cannot be predicted. New laws or regulations that regulate greenhouse gas emissions into the environment may increase our operating costs, including the cost of fuel, and the potential costs of compliance with any such new laws or regulations.

REGULATORY REPORTING

We are not a reporting company under the *Securities Exchange Act of 1934*, as amended ("Exchange Act"), and are not subject to regulation by the Securities and Exchange Commission ("SEC"). However, the PAEA requires us to file with the PRC certain financial reports containing information prescribed by the SEC under Sections 13 and 15(d) of the Exchange Act. These reports include annual reports on Form 10-K ("Annual Report"), quarterly reports on Form 10-Q and current reports on Form 8-K.

We are also required by law and regulations to disclose operational and financial information beyond what the law requires of most U.S. government entities and private-sector companies. Pursuant to Title 39 of the U.S. Code and PRC regulations, we must also file additional information with the PRC, including Cost and Revenue Analysis reports; Revenue, Pieces and Weight reports; financial and strategic plans and the *Comprehensive Statement on Postal Operations*.

All of these reports may be found online at www.about.usps.com/who-we-are/financials/welcome.htm, free of charge, as soon as reasonably practicable after we file them with the PRC. Information on our website is not incorporated by reference into this report. Requests for copies of our reports may also be sent to the following address: Corporate Communications, United States Postal Service, 475 L'Enfant Plaza, SW, Washington, DC 20260-3100.

ITEM 1A. RISK FACTORS

We are subject to various risks and uncertainties that could adversely affect our business, financial condition, results of operations and cash flows. In addition to the risks and uncertainties that are described below, others that we do not yet know of or that we currently believe are immaterial could arise or become material and may also impair our business.

Although the Postal Reorganization Act established our Board with eleven-members, including nine independent Governors, the number of Governors in office is now zero. The President has submitted three nominations to the Senate, but our continuing authority to take certain important actions remains uncertain until and unless we again have Governors in office.

On December 8, 2016, the hold-over term of our last remaining independent Governor expired, and as a result the Board has no presidentially appointed Governors for the first time since we began operations as the United States Postal Service in 1971. During the 114th Congress, the Senate failed to act on any of the President's six nominations to the Board, and those nominations were returned to the President upon the adjournment of that Congress on January 3, 2017. On October 30, 2017, the President submitted three Governor nominations to the Senate, and the process of obtaining Senate confirmation of these nominees is in its earliest stage.

The Temporary Emergency Committee of the Board, which is exercising those powers of the Board necessary for continuity of operations, now consists only of our Postmaster General and Deputy Postmaster General. As described elsewhere in this report, certain powers are vested in the Governors alone. These powers include setting our prices, approving new services and appointing (and, if necessary, removing) our Postmaster General and Deputy Postmaster General. Because no Governors are currently in office, it is uncertain how the important powers reserved to the Governors, including the approval of our prices and fees, can be exercised.

Adverse U.S. and global economic conditions may directly impact our business, negatively affecting results of operations.

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

Current and future management actions to generate cash flows by increasing efficiency, reducing costs and generating additional revenue may not be sufficient to meet all of our financial obligations or to carry out our strategy.

Our strategies to increase efficiency and reduce costs by adjusting our network, infrastructure and workforce and to retain and grow revenue are currently constrained by contractual, statutory, regulatory and political restrictions. Accordingly, our ability to react quickly to the changing economic climate and industry conditions is inhibited. We have also proposed legislative changes that are needed to provide us with the legal authority to implement additional measures to increase efficiency and cost savings and to grow revenue, but nothing we have proposed has become law.

We are subject to congressional oversight and regulation by the PRC and other government agencies. We have a wide variety of stakeholders whose interests and needs are sometimes in conflict.

We operate as an independent establishment of the executive branch of the U.S. government and as a result are subject to a variety of regulations and other limitations applicable to federal agencies. If the U.S. government curtails its spending due to debt ceiling or other constraints, we may be adversely impacted. Additionally, as an outgrowth of our unique status as a fundamental service provider to the nation, we attempt to balance the interests of many parties. Efforts to be responsive to various stakeholders sometimes adversely impact the speed with which we are able to respond to changes in mail volume or other operational needs. Limitations on our ability to take action could adversely affect operating and financial results.

Adverse events may call into question our reputation for quality and reliability or our ability to deliver the mail and could diminish the value of our brand. This could adversely affect our business operations and operating revenue.

Our brand represents quality and reliable service, and therefore is a valuable asset. We use our brand extensively in sales and marketing initiatives and exercise care to defend and protect it. Any event, whether real or perceived, that calls into question our long-term existence, our ability to deliver mail, our quality or our reliability could diminish the value of our brand and reputation and could adversely affect our business operations and operating revenue.

The expiration of the exigent surcharge has had, and will continue to have, an adverse impact on our future operating revenue and liquidity.

In December 2013, the PRC ruled that we could collect a 4.3% exigent surcharge on Market-Dominant services beginning in January 2014, until such time as the surcharge produced $3.2 billion in incremental revenue, or $2.8 billion in contribution, a figure that the PRC determined was lost due to the Great Recession's suppression of mail volume.

We appealed the PRC's decision to the U.S. Court of Appeals for the District of Columbia Circuit (the "Court"), arguing that the PRC attributed to the Great Recession far too little lost mail volume and that the exigent surcharge should remain in effect for as long as it remained necessary. In June 2015, the Court ruled on the appeal and remanded the case back to the PRC for further review, primarily related to the PRC's methodology for calculating mail volume lost due to the Great Recession. Although the Court largely upheld the PRC's analytical framework, it vacated one key aspect of the methodology for calculating mail volume lost due to the Great Recession and suggested the PRC consider another element of its methodology.

On July 29, 2015, the PRC authorized us to collect over $1.4 billion in additional incremental revenue from the surcharge, bringing the total allowed to just over $4.6 billion.

The limit on the amount of the exigent surcharge collected was reached on April 10, 2016, and we therefore reduced the prices of applicable Market-Dominant services on that date. As a result of the expiration of the surcharge, we estimate that our revenue and cash flow for 2017 and 2016 were lower by approximately $2 billion and $1 billion, respectively, than what they otherwise would have been, and it is expected that future revenue and cash flow will be significantly less than they would otherwise have been had the exigent surcharge remained in place.

Our need to modernize our operations in response to declining mail volume may result in significant costs. It is possible that the measures being considered would be insufficient to reduce our workforce and physical infrastructure to a level commensurate with declining mail volume.

Our ongoing reviews of cost-savings opportunities may identify opportunities that impact mail processing operations or affect lobby hours of retail units, Post Offices or other facilities. Presently, our regular review of the carrying value of our assets has not resulted in significant impairment of our physical assets. However, future changes in business strategy, operations, legislation, government regulations or economic or market conditions may result in material impairment write-downs of our assets.

In the future, we may consider offering financial incentives to encourage employees to voluntarily end their employment, as has been done in the past. Any impairment, incentives or other related costs we incur associated with such separations would negatively impact our financial results in the short-term, although we would expect such actions to result in significant long-term savings. We can provide no assurance that the mechanisms available under existing law and contractual arrangements will be sufficient to reduce the workforce or facilities to a level that would allow a return to financial stability.

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

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

Customer usage of postal services continues to shift to substitute products and channels provided by electronic communication services. *First-Class Mail*, such as the presentment and payment of bills, has been eroded by competition from electronic media, driven by some of our major commercial mailers which actively promote the use of online services. *Marketing Mail* has recently experienced declines due to mailers' growing use of digital advertising including digital mobile advertising. The volume of our *Periodicals* service continues to decline as consumers increasingly use electronic media for news and information. Periodical advertising has also experienced a decline as a result of the move to electronic media.

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

In order to offset declining volume and revenue caused by the changing economy and diversion to electronic media, our ability to sell new products and services in new or existing markets will be a key factor in improving our financial condition. However, various laws and regulations significantly limit our ability to enter new markets and/or to provide new services and products, as we are often constrained by traditional industry definitions.

Without legal or regulatory changes that allow us to introduce new products or services to take advantage of our assets, including our strong network and "last-mile" capabilities, we may be unable to respond adequately to consumers' changing needs and expectations. These limitations have the potential to adversely impact our results of operations and long-term financial viability. PAEA currently generally limits price increases on our Market-Dominant services to the rate of inflation as measured by the CPI-U. However, our costs are not similarly limited. A large portion of our cost structure cannot be altered expeditiously, and the number of our delivery points continues to grow. Accordingly, we may not be able to increase prices sufficiently to offset increased costs.

Because our services are provided primarily through our employees, our costs are heavily concentrated in wages and employee and retiree benefits. These costs are significantly impacted by wage inflation, health benefit premium increases, retirement and workers' compensation programs, and COLAs. Some of these costs have historically tended to increase at a higher rate than inflation as measured by the CPI-U. We believe that continuing productivity improvements alone will not be sufficient to address the challenges presented by declining volume and revenue and the regulatory price cap, nor will our efforts to grow operating revenue keep pace with increased cost structures.

Although the Postal Service's Competitive service revenues have increased, this increase is largely due to significant volume growth from three major customers, all of which are building the capability that would enable them to divert volume away from the Postal Service.

The growth in our Competitive service revenues over the past five years is largely attributable to three major customers. Each of those three major customers is building the capability that would enable them to divert volume away from the Postal Service over time. If those customers divert significant volume away from the Postal Service, the growth in our Competitive service revenues may not continue.

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

Our collective bargaining agreements currently in force include provisions for mandatory COLAs, which are linked to the CPI-W. Although CPI-W has been relatively low since 2008 when our employees received COLA-based pay increases of nearly $1.1 billion, a resurgence of consumer inflation could have a significant adverse impact on our labor costs. The agreements also contain provisions that limit our ability to reduce the size of the labor force and employ non-career personnel. Reductions in the size and cost of our labor force may be necessary to offset the effects of declining volume and revenue.

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

Furthermore, an increase in the CPI-W may not correspond to an equivalent increase in the CPI-U, which affects the prices of our Market-Dominant services under current law, as the two indexes are calculated differently. Therefore, we may not be able to increase the prices of our services to keep up with increases in our wages.

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

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

We rely on third-parties for air transportation to deliver our mail throughout the nation and abroad. A significant disruption in air transportation service could adversely affect our business and results of operations.

We do not own or operate aircraft and we rely on third-parties for the air transportation service required to deliver our mail and packages to various destinations within the U.S. and abroad. We are therefore subject to the risk of our partners' business operations and also to the adoption of regulatory requirements and other events that affect specific airlines or the airline industry as a whole, which could affect air service or temporarily ground the fleets of our partners. We may also not be able to negotiate terms as favorable with replacement carriers should one or more of our existing partners experience a disruption.

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

We are exposed to changes in commodity prices, primarily for diesel fuel, unleaded gasoline and aircraft fuel for transportation of mail, and natural gas and heating oil for facilities. For the year ended September 30, 2017, our expenses for fuel represented 2.9% of operating expenses. The price and availability of fuel can be unpredictable and is beyond our control. Additionally, as we also use contracted carriers to transport the mail, we anticipate that increased operating costs for these independent carriers, including increased costs resulting from rising fuel prices, will ultimately be passed through to us.

A failure to protect the privacy of customer information could damage our reputation and result in a loss of business.

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

We rely extensively on computer systems and technology to manage the delivery of mail, process transactions, summarize results and manage our business.

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

Reports of cyber incidents affecting national security, intellectual property and individuals have been widespread, with reported incidents involving data loss or theft, economic loss, computer intrusions and privacy breaches. The source of such threats is wide-ranging. The ability to maintain confidentiality, integrity and availability of information is critical to fulfilling our mission, and system failures resulting from these threats could damage our reputation, resulting in loss of business and increased costs.

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

If our operations do not generate the liquidity we require, we may be forced to reduce, delay or cancel investments in technology, facilities and/or transportation equipment, as we have done in the recent past, while our competitors and other businesses are pursuing advanced, competing technologies and equipment.

Additionally, our aging facilities, equipment and transportation fleet could inhibit our ability to be competitive in the marketplace, deliver a high-quality service and meet the needs of the American public. The changes in the economic landscape in recent years have increased the importance for us to invest in our operations in order to remain competitive. Failure to anticipate or react to our competition, market demands and/or new technology due to inadequate cash reserves is a significant operational risk. An aging or potentially obsolete infrastructure could result in a loss of business and increased costs.

We have a substantial amount of indebtedness.
Since 2012, we have incurred debt obligations to the Federal Financing Bank ("FFB") of $15 billion, the amount of our statutory debt limit. In addition, as of September 30, 2017, we have a total unfunded PSRHBF liability of $62.2 billion, which excludes $38.2 billion due and payable to the PSRHBF for invoiced but unpaid contributions. Additionally, we have estimated unfunded retirement benefits to the CSRS and FERS funds of $26.3 billion and $15.7 billion, respectively, as of September 30, 2017. Our significant indebtedness has important consequences. It limits our flexibility in planning for, or reacting to, changes in the business environment or competition. It places us at a competitive disadvantage compared to commercial competitors that may have less debt and which have access to public capital markets. It also could require us to dedicate a substantial portion of our future cash flow from operations to payments on debt, thus reducing the availability of cash flow to fund working capital, capital expenditures and other general organizational activities.

Health and pension benefit costs represent a significant expense to us.
With approximately 503,000 career employees and over 600,000 retirees who receive benefits, our expenses relating to employee and retiree health and pension benefits are significant. We participate in U.S. government pension and health and benefits programs for employees and retirees, including FEHB, CSRS and the FERS, as required by law. We have no control or influence over the benefits offered by these plans and are required to make contributions to these plans as specified by law or contractual agreements with our unions (in the case of health benefits for most active employees). Several factors including participant mortality rates, returns on investment, and inflation could require us to make significantly higher future contributions to these plans, and all of these factors are beyond our control.

In recent years, we have experienced significant increases in retiree health benefits costs, primarily as a result of PAEA, which obligates us to fully prefund, on an accelerated time frame, the health benefits of current Postal Service employees and retirees. Additionally, we are required to continue contributing to the FERS pension program at rates specified by the Office of Personnel Management ("OPM") and to make an amortization payment for the unfunded liability. We were required, beginning in 2017, to resume contributions to the CSRS, which were suspended under PAEA through 2016, given that OPM determines that unfunded liability payments are necessary.

Workers' compensation insurance and claims expenses could have a material adverse effect on our business, financial condition and results of operations.
Workers' compensation liabilities are established for estimates of cash outlays that we are expected to ultimately incur on reported claims, as well as estimates of the costs of claims that have been incurred but not yet reported. Trends in actual experience and management judgments about the present and expected levels of cost per claim are significant factors in the determination of such accruals. Several other factors which are beyond our control, such as discount and inflation rates, could cause us to incur higher workers' compensation expenses.

We believe our estimated liability for such claims is adequate, but if actual experience in the number of claims, and/or severity of claims for which we retain risk increases, this could cause a material difference from our estimates and adversely affect our financial condition and results of operations. In addition, our workers' compensation program is administered for us by the DOL, and as such, we do not have the same level of control over the execution of the program, including the costs we incur for certain medical and pharmacy costs, that a private company has with its workers' compensation insurance provider.

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

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

Natural disasters, such as hurricanes, earthquakes, tornadoes, floods, wildfires and severe winter storms place our employees in harm's way and make it challenging to deliver mail under these unpredictable and dangerous conditions. Damage to our facilities could also have a negative impact on business operations. Significant additional operating costs may be incurred in order to maintain continuity in fulfilling our mission.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

We own over 8,400 and lease over 23,000 Postal Service facilities ranging in size from 60 square feet to 32 acres. Our facilities support retail, delivery, mail processing, maintenance, administrative and support activities and are located in numerous communities throughout the U.S. and its territories. We believe our properties are generally in good physical condition and require only routine repairs and maintenance and periodic capital improvements. In addition, we monitor the productive capacity of our properties and our operational needs, which may, from time to time, result in the consolidation of some of our facilities.

ITEM 3. LEGAL PROCEEDINGS

As previously reported, on January 14, 2010, the Equal Employment Opportunity Commission's Office of Federal Operations certified the case *McConnell v. Brennan* (first instituted in 2006 as *McConnell v. Potter*) as a class action against the Postal Service, with the class consisting of all permanent-rehabilitation and limited-duty Postal Service employees who were assessed under the Postal Service's National Reassessment Process ("NRP") between the dates of May 5, 2006, and July 1, 2011. The NRP was a program that we utilized to ensure that our records regarding employees injured on the job were correct and that employees receiving workers' compensation benefits were placed in jobs consistent with their abilities.

The case alleges violations of the *Rehabilitation Act of 1973* resulting from the NRP's failure to provide a reasonable accommodation, the NRP's wrongful disclosure of medical information, the creation by the NRP of a hostile work environment and the NRP's adverse impact on disabled employees. The class is seeking injunctive relief and damages of an uncertain amount. If the plaintiffs were able to prove their allegations in this matter and to establish the damages they assert, an adverse ruling could have a material impact on us. We continue to dispute the claims asserted in the case and are vigorously contesting the matter.

We are subject to other legal proceedings and claims that arise in the ordinary course of our business. For further discussion of the legal proceedings affecting us, see *Item 8. Financial Statements and Supplementary Data*, *Notes to Financial Statements*, *Note 9 - Commitments and Contingencies*.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

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

ITEM 6. SELECTED FINANCIAL DATA

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

(in millions)	2017	2016	2015	2014	2013
Operating results					
Revenue:					
Total revenue before temporary exigent surcharge and change in accounting estimate	$ 69,636	$ 69,301	$ 66,810	$ 66,427	$ 66,002
Temporary exigent surcharge[1]	—	1,136	2,118	1,403	—
Total revenue before change in accounting estimate	$ 69,636	$ 70,437	$ 68,928	$ 67,830	$ 66,002
Change in accounting estimate[2,3]	—	1,061	—	—	1,316
Total revenue	**$ 69,636**	**$ 71,498**	**$ 68,928**	**$ 67,830**	**$ 67,318**
Operating expenses:					
Compensation and benefits	$ 49,108	$ 48,441	$ 47,278	$ 45,993	$ 46,708
Unfunded retirement benefits	2,658	248	241	7	—
Retiree health benefits	4,260	9,105	8,811	8,685	8,450
Workers' compensation	(797)	2,682	1,760	2,554	1,061
Transportation	7,238	6,992	6,579	6,586	6,735
All other operating expenses	9,743	9,431	9,157	9,353	9,174
Total operating expenses	**$ 72,210**	**$ 76,899**	**$ 73,826**	**$ 73,178**	**$ 72,128**
Loss from operations	**$ (2,574)**	**$ (5,401)**	**$ (4,898)**	**$ (5,348)**	**$ (4,810)**
Net loss	**$ (2,742)**	**$ (5,591)**	**$ (5,060)**	**$ (5,508)**	**$ (4,977)**
Financial position					
Assets:					
Cash and cash equivalents	$ 10,513	$ 8,077	$ 6,634	$ 4,906	$ 2,326
Property and equipment, net	14,891	15,296	15,686	16,338	17,512
All other assets	1,990	1,846	1,694	1,718	1,803
Total assets	**$ 27,394**	**$ 25,219**	**$ 24,014**	**$ 22,962**	**$ 21,641**
Liabilities:					
Accrued retiree health benefits	$ 38,160	$ 33,900	$ 28,100	$ 22,417	$ 16,766
Workers' compensation liability	17,910	20,039	18,811	18,422	17,240
Debt	15,000	15,000	15,000	15,000	15,000
All other liabilities	15,048	12,262	12,494	12,454	12,458
Total liabilities	**$ 86,118**	**$ 81,201**	**$ 74,405**	**$ 68,293**	**$ 61,464**
Total net deficiency	**$(58,724)**	**$(55,982)**	**$(50,391)**	**$(45,331)**	**$(39,823)**

[1] The PRC authorized that we could collect a 4.3% exigent surcharge on Market-Dominant service beginning in January 2014 until such time that the surcharge produced just over $4.6 billion in incremental revenue. The limit was reached and the temporary exigent surcharge expired on April 10, 2016.

[2] The 2016 change in accounting estimate relates to changes in estimates of stamp usage and breakage for *Forever Stamps* sold from 2011 through June 30, 2016, reflected as a decrease in the *Deferred revenue-prepaid postage* liability as of June 30, 2016.

[3] The 2013 change in accounting estimate resulting from new analytics which revised the estimated liability associated with the *Deferred revenue-prepaid postage* for *Forever Stamps* as of September 30, 2013.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

CAUTIONARY STATEMENTS

The following *Management's Discussion and Analysis of Financial Condition and Results of Operations* and other parts of this report describe the principal factors affecting our financial results, liquidity, capital resources and critical accounting estimates. Our results of operations may be impacted by risks and uncertainties, many of which we cannot control or influence, and may cause actual results to differ materially from those currently contemplated.

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 forward-looking statements, which involve a number of risks and uncertainties, reflect current expectations regarding future events and operating performance as of the date of this report.

We have no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise. Important factors that could cause actual results to differ materially from those anticipated in our forward-looking statements include, but are not limited to, those described under *Item 1A. Risk Factors*.

OVERVIEW

With our mandate to provide universal postal services to the nation, we serve retail and commercial customers in the U.S. as well as internationally. Our operations include an extensive and integrated retail, distribution, transportation and delivery network, and we operate as a single segment throughout the U.S., its possessions and territories.

We have successfully implemented initiatives that have reduced our costs by billions of dollars while offering broader services. However, legal restrictions on pricing, service diversification and operations restrict our ability to cover our costs to provide secure, reliable and affordable postal services to the nation.

We have established a core set of goals that drive our strategic initiatives and continuous improvement efforts:

1. Deliver a world-class customer experience;
2. Equip, empower and engage employees;
3. Innovate faster to deliver value; and
4. Invest in our future platforms.

As part of these efforts, we aim to achieve long-term financial stability, as well as a reduction in our debt. Our focus on maintaining liquidity and reducing operating expenses reflects current trends, as well as projected future volume of mail and packages. We believe that financial stability is within reach with targeted legislative and regulatory reform as we continue to identify and create innovative and affordable services, and deliver high levels of performance and service.

RESULTS OF OPERATIONS

SUMMARY

The major factors that impact our operating results include overall customer demand, the mix of postal services and contribution associated with those services, volume of mail and packages processed through our network and our ability to manage our cost structure in line with declining levels of mail volume, growth in more labor-intensive Shipping and Packages volume and an increasing number of delivery points. We operate as a single segment and report our performance as such.

<u>2017 Compared with 2016</u>

Our reported operating revenue was $69.6 billion in 2017, a decrease of $1.8 billion, or 2.6%, from the prior year. This decrease was due to the combined effects of the $1.1 billion one-time, non-cash adjustment for deferred revenue in the prior year, discussed below in *2016 Change in Accounting Estimate*, and the April 2016 expiration of the exigent surcharge, which generated approximately $1.1 billion in incremental revenue during 2016. Excluding the effects of both the 2016 change in accounting estimate and the expiration of the exigent surcharge, operating revenue for the year ended September 30, 2017, would have increased by $361 million, or 0.5%, from the prior year on a 3.1% decrease in volume.

As more fully described below in *Operating Revenue and Volume*, combined revenue from *First-Class Mail* and *Marketing Mail* declined by $2.9 billion for the year ended September 30, 2017, compared to the prior year. This decline was attributable to a decline in combined volume of 5.0 billion pieces, as well as the exigent surcharge expiration. These declines in *First-Class Mail* and *Marketing Mail* revenue were partially offset by the increase in Shipping and Packages revenue of $2.1 billion, or 11.8%, as we continued to experience growth in this business throughout 2017.

As more fully described below in *Operating Expenses*, our 2017 operating expenses decreased $4.7 billion, or 6.1%, compared to the prior year. The decrease in operating expenses was primarily due to a decrease in retiree health benefits expense of $4.8 billion, resulting from the expiration of the PAEA lump sum statutory funding schedule, and a decrease in the fair market value of the workers' compensation liability of $2.4 billion as discount rates increased in 2017 compared to the prior year. These decreases were partially offset by increased unfunded retirement benefits costs of $2.4 billion resulting from provisions of the PAEA that became effective in 2017 and changes in actuarial estimations, increased compensation and health benefits expense of $667 million and, to a lesser extent, increased transportation costs of $246 million, the result of increased highway expenses.

This resulted in a net loss of $2.7 billion for the year ended September 30, 2017, compared to a net loss of $5.6 billion for 2016.

2016 Compared with 2015

Our reported operating revenue was $71.4 billion in 2016, an increase of $2.6 billion, or 3.8%, from the prior year. Excluding the effect of a nearly $1.1 billion non-cash adjustment for deferred revenue, discussed below in *2016 Change in Accounting Estimate*, operating revenue was nearly $70.4 billion for 2016, an increase of $1.6 billion, or 2.3%, from the prior year.

As more fully described below in *Operating Revenue and Volume*, this increase in our 2016 operating revenue was driven by an increase in our Shipping and Packages revenue of $2.4 billion, or 15.7%, although this was partially offset by a decline in *First-Class Mail* of $904 million, and the April 10, 2016, expiration of the exigent surcharge, which reduced 2016 operating revenue by approximately $1 billion from what it otherwise would have been. The expiration of the surcharge most significantly impacted revenue associated with *First-Class Mail* and *Marketing Mail*, impacting certain other Market-Dominant services to a lesser extent.

As more fully described below in *Operating Expenses*, 2016 operating expenses increased $3.1 billion, or 4.2%, compared to the prior year. The increase in operating expenses was due to increased compensation and benefits expense of $1.2 billion resulting primarily from an increase in labor hours, and an increase in workers' compensation expense of $922 million as discount rates declined in 2016 compared to the prior year. Additionally, transportation costs grew by $413 million, driven by an increase in both air and highway transportation in support of the Shipping and Packages volume growth and our strategic efforts to continue to improve our delivery service.

This resulted in a net loss of $5.6 billion for the year ended September 30, 2016, compared to a net loss of $5.1 billion for 2015. Although Shipping and Packages drove the growth in operating revenue, these gains were outpaced by increases in operating expenses, driven by compensation and benefits, and to a lesser extent, workers' compensation expenses largely outside of management's control.

2016 Change in Accounting Estimate

We recognize revenue for postage at the time a piece of mail is processed and delivered, not when we receive cash for the sale of postage. We estimate the amount of postage that we have sold, but customers have not yet used, and include this amount as a liability in our *Balance Sheets* as *Deferred revenue-prepaid postage*. The majority of this liability consists of our estimate of sold, but unused, *Forever Stamps*, the non-denominated postage stamps we introduced in 2007.

We have developed and validated the usage portion of our deferred revenue estimate through complex mathematical and statistical methods, including regression analysis, of postage stamp usage trends. Small differences in inputs can lead to significant differences in our estimate of the liability. "Breakage" represents the portion of sold *Forever Stamps* that we estimate will never be used by customers due to loss, damage or stamp collection. Assumptions regarding estimated usage and breakage of a particular postage stamp issue cannot be refined until each "series" of postage stamps nears the end of its life cycle.

During 2016, we revised the estimation technique utilized to estimate our *Deferred revenue-prepaid postage* liability for *Forever Stamps*. The change resulted from new information regarding customer's retention and usage habits of applicable postage, and enabled the Postal Service to update its estimate of stamps that will never be used for mailing. As a result of this change, *Deferred revenue-prepaid postage* was decreased by nearly $1.1 billion. In accordance with accounting principles generally accepted in the U.S. ("GAAP"), the change was accounted for as a change in accounting estimate, and was reflected in operating results as an increase to revenue and a decrease in net loss by the same amount in the year ended September 30, 2016. This adjustment had no impact on our liquidity nor did it lessen the severity of our liquidity outlook.

Non-GAAP Controllable (Loss) Income

In the day-to-day operation of our business, we focus on costs within our control, such as salaries and transportation. We calculate controllable (loss) income, a non-GAAP measure, by excluding items we cannot control, such as PSRHBF actuarial revaluation and amortization expenses, workers' compensation expenses caused by actuarial revaluation and discount rate changes, retirement expenses caused by actuarial revaluation, and adjustments for non-recurring items, such as the change in accounting estimate for *Deferred revenue-prepaid postage*. Controllable (loss) income should not be considered a substitute for net (loss) income and other GAAP reporting measures. The following table reconciles our GAAP net loss to controllable (loss) income for the years ended September 30, 2017, 2016 and 2015:

(in millions)	2017	2016	2015
Net loss	**$ (2,742)**	**$ (5,591)**	**$ (5,060)**
PSRHBF unfunded liability expense[1]	955	—	—
PSRHBF prefunding fixed amount[2]	—	5,800	5,700
Change in workers' compensation liability resulting from fluctuations in discount rates	(1,362)	1,026	809
Other change in workers' compensation liability[3]	(850)	188	(502)
Change in accounting estimate[4]	—	(1,061)	—
CSRS unfunded liability expense[5]	1,741	—	—
FERS unfunded liability expense[6]	917	248	241
Change in normal cost of retiree health benefits due to revised actuarial assumptions[7]	527	—	—
Controllable (loss) income	**$ (814)**	**$ 610**	**$ 1,188**

[1] Expense for the annual payment due by September 30, 2017, on the unfunded liability as calculated by OPM.

[2] Expense for the annual prefunding payments to the PSRHBF due on September 30, 2016, and 2015, upon which the Postal Service defaulted.

[3] Net amounts include changes in assumptions, as well as the valuation of new claims and revaluation of existing claims, less current year claim payments.

[4] This change in accounting estimate relates solely to changes in estimates of stamp usage and breakage for *Forever Stamps* sold from 2011 through June 30, 2016, reflected as a decrease in the *Deferred revenue-prepaid postage* liability as of June 30, 2016.

[5] Expense for the annual payment due September 30, 2017, calculated by OPM, to amortize the unfunded CSRS retirement obligation as of September 30, 2016, the date of the most recent available information. Payments are to be made in equal installments through 2043.

[6] Expense for the annual payment due September 30, 2017, calculated by OPM, to amortize the unfunded FERS retirement obligation as of September 30, 2016, the date of the most recent available information. Payments are to be made in equal installments through 2046.

[7] Represents the annual portion of the normal cost payment due September 30, 2017, attributable to revised actuarial assumptions and discount rate changes. The total normal cost payment amount, calculated by OPM, is $3.3 billion.

For the year ended September 30, 2017, we recognized an $814 million controllable loss compared to $610 million of controllable income in 2016, a net decrease of $1.4 billion. This decrease was driven by the $775 million decline in operating revenue before the change in accounting estimate, along with increases in compensation and benefits of $667 million and transportation expenses of $246 million, respectively. These items are discussed in greater detail in *Operating Revenue and Volume* and *Operating Expenses*.

For the year ended September 30, 2016, controllable income decreased by $578 million from the prior year. This decrease was driven by increases in compensation and benefits, retiree health benefits, transportation expenses and other operating expenses of $1.2 billion, $294 million, $413 million and $274 million, respectively, partially offset by the $1.6 billion increase in operating revenue before the 2016 change in accounting estimate. These items are discussed in greater detail in *Operating Revenue and Volume* and *Operating Expenses*.

OPERATING REVENUE AND VOLUME

Combined *First-Class Mail* and *Marketing Mail* have continued to provide the majority of our operating revenue. As a percentage of operating revenue, *First-Class Mail* and *Marketing Mail* combined represented 60.7%, 64.1% and 67.0% (before the 2016 change in accounting estimate) for the years ended September 30, 2017, 2016 and 2015, respectively. *First-Class Mail* and *Marketing Mail* combined volume represented 91.7%, 92.1% and 92.4% in 2017, 2016 and 2015, respectively.

While we continue to experience strong results in our Shipping and Packages business, it represented only 28% of our revenues for the year ended September 30, 2017, compared to *First-Class Mail*, which represented 37%. Furthermore, Shipping and Packages generated only 4% of our volume for the year ended September 30, 2017, and the costs to process and deliver Shipping and Packages services are higher than the costs associated with *First-Class Mail* on a per-piece or package basis.

Although revenue and volume are closely linked to the strength of the U.S. economy and changes in how our customers use the mail, we have proactively targeted opportunities to grow our business. We continue to concentrate on our customers' needs and have increased our marketing investment and focus on mail and package innovation. However, we also recognize that revenue growth is constrained by laws and regulations restricting the types of products, services and pricing we may offer to our customers and the speed with which we can bring new products to market.

We anticipate that *First-Class Mail* will continue to lose volume in future years with the migration to electronic communication and transactional alternatives resulting from technological changes. To address the long-term trend that such changes have had on our *First-Class Mail* revenue and volume, we have focused on providing new services and innovating with *Marketing Mail.* We have expanded service offerings such as *Informed Delivery*, which enables customers to preview mail, as well as manage packages scheduled to arrive, as a means of merging digital and physical mail. We believe these service offerings will serve to stabilize *Marketing Mail* volume.

With our Shipping and Packages business, we have focused on growing e-commerce and implementing marketing campaigns that have helped us grow this business. By offering day-specific delivery, improved tracking and text alerts and up to $50 of free insurance on most *Priority Mail* packages, we have demonstrated our responsiveness to our customers.

As described below, we implemented price increases on various Market-Dominant and Competitive services in May 2015, January 2016, January 2017 and September 2017. We have filed with the PRC notices of our intent to increase prices for certain Market-Dominant and Competitive services by an average of 1.9% and 4.1%, respectively. On November 7, 2017, and November 9, 2017, the PRC approved the Competitive service price increase plan and the Market-Dominant service price increase plan, respectively. These price increases will both go into effect on January 21, 2018.

As referenced throughout this report, the PRC authorized us to collect an exigent surcharge on most Market-Dominant services beginning in January 2014 until it produced incremental revenue of just over $4.6 billion, a figure the PRC determined was lost due to the Great Recession's suppression of mail volume. The limit on the amount of the exigent surcharge collected was reached on April 10, 2016, and we therefore reduced the prices of applicable Market-Dominant services on that date. As a result of the expiration of the surcharge, we estimate that our revenue and cash flow for 2017 and 2016 were lower by approximately $2 billion and $1 billion, respectively, than what they otherwise would have been, and it is expected that future revenue and cash flow will also be significantly less than they would otherwise have been had the exigent surcharge remained in place.

The following table details our operating revenue and volume for the years ended September 30, 2017, 2016 and 2015 by service category:

(in millions)	2017	2016	2015
Operating revenue:			
First-Class Mail[1]	$ 25,637	$ 27,508	$ 28,412
Marketing Mail[2]	16,626	17,622	17,646
Shipping and Packages[3]	19,481	17,427	15,061
International	2,723	2,674	2,702
Periodicals	1,375	1,507	1,589
Other[4]	3,751	3,630	3,380
Operating revenue before change in accounting estimate	**$ 69,593**	**$ 70,368**	**$ 68,790**
Change in accounting estimate	—	1,061	—
Total operating revenue	**$ 69,593**	**$ 71,429**	**$ 68,790**
Volume:			
First-Class Mail[1]	58,747	61,240	62,599
Marketing Mail[2]	78,329	80,885	80,030
Shipping and Packages[3]	5,748	5,159	4,539
International	1,003	1,005	913
Periodicals	5,301	5,586	5,838
Other[5]	363	467	402
Total volume	**149,491**	**154,342**	**154,321**

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

[1] Excludes *First-Class Mail Parcels*.

[2] Excludes *Marketing Mail Parcels*.

[3] Includes *Priority Mail*, *Priority Mail Express, USPS Retail Ground*, *Parcel Select Mail*, *Parcel Return Service Mail*, *Marketing Mail Parcels*, *Package Service Mail*, *First-Class Mail Parcels, First-Class Package Service* and *Priority Mail Express.* Excludes International packages.

[4] Includes *PO Box* services, *Certified Mail*, Return Receipts, Insurance, Other Ancillary Services, Shipping and Mailing Supplies, Collect on Delivery, Registered Mail, Stamped Envelopes and Cards, money orders and Other services.

[5] Volume includes Postal Service internal mail and free mail provided to congressionally-mandated groups.

First-Class Mail

First-Class Mail, presented in this report as a mail class and a service category, includes cards, letters and flats, and is priced the same regardless of the distance the mail travels. The volume of *First-Class Mail*, our most profitable service category, continues to decline, with decreases of 4.1% in 2017 and 2.2% in 2016, due to the continuing migration toward electronic communication and electronic transaction alternatives. *First-Class Mail* generated approximately 39%, 40% and 41% of the total volume for the years ended September 30, 2017, 2016 and 2015, respectively, but represented approximately 37%, 39% and 41% of operating revenue for the three years ended September 30, 2017, 2016 and 2015, respectively.

For the year ended September 30, 2017, *First-Class Mail* revenue fell by $1.9 billion, or 6.8%, on a volume decline of 4.1%, compared to the prior year. The percentage of decline in revenue was greater than the percentage of decline in volume for 2017 due to the April 10, 2016, expiration of the exigent surcharge, which we estimate generated approximately $648 million in incremental *First-Class Mail* revenue in the first six months of 2016. The prices of certain *First-Class Mail* services also increased in January 2017, but the CPI increase was not sufficient to offset the loss of the exigent prices and lower volume.

For the year ended September 30, 2016, *First-Class Mail* revenue decreased by $904 million, or 3.2%, on a volume decline of 2.2%, compared to the prior year. The percentage of decline in revenue was greater than the percentage of decline in volume for the year due to the April 10, 2016, expiration of the exigent surcharge. We estimate that approximately $550 million of the decline in *First-Class Mail* revenue during 2016 was attributable to the surcharge expiration.

Marketing Mail

USPS Marketing Mail (more commonly, *Marketing Mail*), presented as a mail class and a service category, is mail not required to be processed and delivered as *First-Class Mail* or *Periodicals*, and may include advertising, newsletters, catalogs, small marketing parcels and other printed matter. *Marketing Mail* volume is reflective of the cyclical nature of the U.S. economy and competition from other forms of advertising. Price increases for *Marketing Mail* are generally capped at the rate of inflation because they are classified by law as Market-Dominant.

Marketing Mail generated approximately 52% of the total volume, but represented approximately 24%, 25% and 26% of operating revenue for the three years ended September 30, 2017, 2016 and 2015, respectively. *Marketing Mail* had experienced relatively stagnant volume between 2009 and 2016, although its share of the total advertising market declined somewhat due to the continued migration toward electronic communication. *Marketing Mail* has generally proven to be a relatively resilient marketing channel, and its value to U.S. businesses remains strong due to better data and technology integration.

For the year ended September 30, 2017, *Marketing Mail* revenue decreased $1.0 billion, or 5.7%, on a volume decline of 3.2%, compared to the prior year. The percentage of decline in revenue was greater than the percentage of decline in volume for 2017 due to the April 10, 2016, expiration of the exigent surcharge, which we estimate generated approximately $396 million in incremental *Marketing Mail* revenue in the first six months of 2016. Revenue and volume were also adversely affected by a reduction in mail advertising campaigns by certain large mailers.

For the year ended September 30, 2016, *Marketing Mail* revenue decreased slightly by $24 million, or 0.1%, despite a volume increase of 1.1%, compared to the prior year. We estimate that the incremental revenue decline in *Marketing Mail* due to the expiration of the exigent surcharge was approximately $335 million during 2016.

Shipping and Packages

Our Shipping and Packages category consists largely of Competitive services that can be priced to reflect current market conditions. These include *Priority Mail, Priority Mail Express*, *Parcel Select* and *Parcel Return*. *First-Class Package Services - Retail*, *First-Class Package Services - Commercial*, and certain other package delivery classes are also part of Shipping and Packages, but are considered Market-Dominant services and are therefore subject to price caps.

As a percentage of operating revenue, Shipping and Packages generated approximately 28%, 25% and 22% for the years ended September 30, 2017, 2016 and 2015, respectively. As a percentage of total volume, Shipping and Packages represented 3.8%, 3.3% and 2.9% for the years ended 2017, 2016 and 2015, respectively. Prices for these Competitive services increased an average of 9.5% in January 2016 and 3.5% in May 2015.

For the year ended September 30, 2017, Shipping and Packages revenue grew by 11.8% on volume growth of 11.4%, compared to the prior year. For the year ended September 30, 2016, Shipping and Packages revenue grew by 15.7% on volume growth of 13.7%, compared to the prior year.

Our Shipping and Packages business has continued to show solid revenue and volume growth as a result of our successful efforts to compete in shipping services, including "last-mile" e-commerce fulfillment markets and Sunday delivery. Volume also experienced end-to-end growth as consumers continued to utilize online shopping, which provided a surge in package volume with a record number of packages delivered during the calendar year 2016 and 2015 holiday seasons. To accommodate the surge in volume and to avoid service disruptions during the holiday season, we have increased Sunday delivery service for some of our customers in limited U.S. markets and are again adding employees for the holiday season.

The following table details our operating revenue and volume for Shipping and Packages for the years ended September 30, 2017, 2016 and 2015 by each service:

(in millions)	2017	2016	2015
Shipping and Packages revenue:			
Priority Mail Services[1]	$ 9,456	$ 9,015	$ 8,443
Parcel Services[2]	5,891	4,830	3,516
First-Class Packages[3]	3,333	2,782	2,292
Package Services	801	800	810
Total Shipping and Packages revenue	**$ 19,481**	**$ 17,427**	**$ 15,061**
Shipping and Packages volume:			
Priority Mail Services[1]	1,072	1,062	1,043
Parcel Services[2]	2,905	2,478	1,997
First-Class Packages[3]	1,151	1,028	933
Package Services	620	591	566
Total Shipping and Packages volume	**5,748**	**5,159**	**4,539**

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

[1] Includes *Priority Mail*, a 1-3 business day delivery service; *Priority Mail Express*, an overnight delivery service available 365 days per year; and *USPS Retail Ground,* a retail-only Market-Dominant service priced identically and functionally equivalent to *Priority Mail* for Zones 1-4.

[2] Includes *Parcel Select*, *Parcel Return* and *Marketing Mail Parcels*.

[3] Includes *First-Class Package Service - Retail* (formerly *First-Class Mail Parcels*) and *First-Class Package Service - Commercial* (formerly *First-Class Package Service*).

Priority Mail Services

Priority Mail Services includes *Priority Mail*, *Priority Mail Express* and *Retail Ground*, and allows customers the ability to send documents and packages requiring expedited transportation and handling. As our flagship Shipping and Packages subcategory for retail and commercial customers, Priority Mail Services accounted for 48.5%, 51.7% and 56.1% of Shipping and Packages revenue for the years ended 2017, 2016 and 2015, respectively. While Priority Mail Services continues to grow year-over-year, it is somewhat price sensitive, and its growth rate is lower than some other Shipping and Packages subcategories used by commercial customers.

For the year ended September 30, 2017, Priority Mail Services revenue grew by 4.9% on volume growth of 0.9%, compared to the prior year. The January 2017 price increase in Competitive services contributed to higher growth in revenue versus volume for the year ended September 30, 2017.

For the year ended September 30, 2016, Priority Mail Service revenue grew by 6.8% on volume growth of 1.8%, compared to the prior year. The January 2016 price increase in Competitive services contributed to higher growth in revenue versus volume for the year ended September 30, 2016.

Parcel Services

The Parcel Services subcategory includes *Parcel Select*, *Parcel Return*, which are Competitive services largely consisting of "last-mile" deliveries, and *USPS Marketing Mail Parcels* (more commonly, *Marketing Mail Parcels*), which is a Market-Dominant service. Parcel Services accounting for 30.2%, 27.7% and 23.3% of Shipping and Packages revenue for the years ended September 30, 2017, 2016 and 2015, respectively. Parcel Services showed strong revenue growth of 22.0% and 37.4% and volume growth of 17.2% and 24.1% for the years ended September 30, 2017, and 2016, respectively.

The increase in year-over-year growth for Parcel Services revenue and volume were driven largely by the continuing growth of e-commerce, which largely affects our *Parcel Select* service, and our competitive pricing on these services. This high-growth subcategory has rapidly become a significant contributor to our overall Shipping and Packages growth. However, because *Parcel Select* services are pre-sorted by customers and bypass most of our processing network, these are some of our lowest-priced services with a relatively lower contribution margin, and as a result, do not provide as much revenue when compared to many of our other services.

First-Class Packages

The First-Class Packages subcategory includes the competitively priced *First-Class Package Service - Commercial* (formerly *First-Class Package Service*), an under one-pound Competitive service targeted to commercial customers, and *First-Class Package Service - Retail* (formerly *First-Class Mail Parcels*), an under 13-ounce retail package service. In September 2017, aside from the name change, *First-Class Package Service - Retail* was transferred from a Market-Dominant service to a Competitive service. First-Class Packages offers customers that ship primarily lightweight fulfillment parcels the lowest priced expedited end-to-end shipping option in the marketplace. First-Class Packages revenue and volume performance has experienced strong increases for the past three years, primarily attributable to growth in e-commerce.

For the year ended September 30, 2017, First-Class Packages revenue increased 19.8% on volume growth of 12.0%, compared to the prior year. For the year ended September 30, 2016, First-Class Packages revenue grew by 21.4% on volume growth of 10.2%, compared to the prior year. The higher growth in revenue compared to volume for both 2017 and 2016 was due in large part to the impacts of the January 2017 and January 2016 price increases in Competitive services.

Package Services

Customers use our Package Services subcategory for shipping merchandise or bound printed matter, including library and media mail, weighing up to 70 pounds. For the year ended September 30, 2017, Package Services revenue increased by 0.1%, on volume growth of 4.9%, compared to the prior year. For the year ended September 30, 2016, Package Services revenue decreased by 1.2% on volume growth of 4.4%, compared to the prior year. Volume has increased more than revenue in this category because certain large mailers are tendering packages deeper in our network, offset by a lower price per piece on bound printed matter.

International Mail

International Mail includes several services that enable customers, both domestic and abroad, to send international mail and packages, including postcards, envelopes, flats and packages, with either standard or express delivery options. Our revenue from International Mail, the majority of which is generated from "outbound services" that allow customers in the U.S. to send mail and packages to other countries, was 3.9%, 3.8% and 3.9% of total operating revenue for 2017, 2016 and 2015, respectively. For the past several years, we have experienced an increase in lower-priced inbound mail volume, much of that from tracked letter packets and parcels related to international e-commerce.

For the year ended September 30, 2017, International Mail revenue increased by 1.8% despite a volume decline of 0.2%, compared to the prior year. The January 2017 price increases positively affected revenue from *First-Class International Package Service* and other international Competitive services, which offset the revenue lost from declines in higher-priced outbound volume. We continue to experience an increase in lower-priced inbound mail volume, much of that from tracked letter packets and parcels related to international e-commerce. This increase in inbound volume was not enough to offset declines in *First-Class Mail International* and other outbound volume.

For the year ended September 30, 2016, International Mail revenue decreased by 1.0% while volume increased by 10.1%, compared to the prior year. This was also due to the increase in lower-priced inbound mail volume, much of that from tracked letter packets and parcels related to international e-commerce, which was not enough to offset declines in *First-Class Mail International* and other outbound volume. The January 2016 price increases positively affected revenue from *First-Class International Package Service* and other international Competitive services, but this was not enough to offset the revenue lost from declines in higher-priced outbound volume.

Periodicals

Periodicals, also presented as a mail class and a service category, is designed for newspapers, magazines and other periodical publications whose primary purpose is transmitting information to an established list of subscribers or requesters. For the year ended September 30, 2017, *Periodicals* revenue decreased by 8.8% and volume decreased by 5.1%, compared to the prior year. For the year ended September 30, 2016, *Periodicals* revenue decreased by 5.2% and volume decreased by 4.3%, compared to the prior year.

Periodicals revenues and volumes have been in decline since 1990. This trend shows no sign of abating, as reading behavior and advertising shifts from print to other media. We do not expect *Periodicals* to rebound as e-readers and electronic content continue to grow in popularity with the public.

Other

Other services include ancillary services such as *Certified Mail*, *PO Box* services and *Return Receipt* services. Also included in this category are money orders, passport services, "signature on delivery" services, insurance, and our own internal mail, which generates no revenue and has volume that can vary significantly from year to year.

For the year ended September 30, 2017, Other services revenue increased by 3.3%, compared to the prior year. For the year ended September 30, 2016, Other services revenue increased by 7.4%, compared to the prior year.

OPERATING EXPENSES

In an effort to align our resources with anticipated types of services and mail volume, we continue to manage operating expenditures under management's control.

As described above in *Operating Revenue and Volume*, we anticipate that the continued migration of communications and commerce to electronic media will adversely affect *First-Class Mail* volume and revenue for the foreseeable future. Although increased Shipping and Packages volume has offset some of these declines, the costs of transporting and delivering packages on a per-piece basis are higher than the costs for *First-Class Mail*.

Our challenge to contain costs is compounded by the continuing increase in the number of delivery points, which, when combined with the impact of lower hard copy mail volume, has resulted in a drop in the average number of pieces delivered per delivery point per day from approximately 5.5 pieces in 2007 to 3.6 pieces in 2017, a reduction of approximately 35%.

Furthermore, our mail processing and distribution network was originally designed to provide overnight delivery service of *First-Class Mail* within specified delivery areas for a much higher volume of mail than what we process and deliver today, and therefore the network's legacy capabilities are excessive relative to today's mail volume. Consequently, many of our processing and distribution facilities continue to operate at much less than full capacity.

Compensation and Benefits

Compensation and benefits, our largest operating expense category, represented approximately 68%, 63% and 64% of our total operating expenses for the years ended September 30, 2017, 2016 and 2015, and consist of costs related to our active career and non-career employees.

The majority of our employees participate in either CSRS or FERS based on the starting date of employment with us or another U.S. government employer. Employees may also participate in the Thrift Savings Plan ("TSP"), a defined contribution savings and investment plan administered by the Federal Retirement Thrift Investment Board. By law, we do not incur normal costs for CSRS retirement benefits.

For the year ended September 30, 2017, compensation and benefits increased by 1.4%, compared to a 2.5% increase the prior year. The following table provides the components of compensation and benefits for active employees as of September 30, 2017, 2016 and 2015:

(in millions)	2017	2016	2015
Compensation	$ 37,026	$ 36,634	$ 35,931
FERS employees' current year service	6,604	6,509	6,239
Employee health benefits	5,163	4,972	4,774
Other	315	326	334
Total compensation and benefits	**$ 49,108**	**$$ 48,441**	**$ 47,278**

Compensation

During the year ended September 30, 2017, compensation expense increased $392 million, or 1.1%, compared to 2016. The 2017 increase was attributable primarily to contractually-obligated salary escalations, and additional work hours, driven by the more labor-intensive Shipping and Package business, partially offset by the impact of attrition of higher paid employees, who were largely replaced by newly converted career employees and non-career employees earning lower wages.

During the year ended September 30, 2016, compensation expense increased $703 million, or 2.0%, compared to 2015.This increase was attributable to contractually-obligated salary escalations and additional work hours associated in large part with growth in the more labor-intensive Shipping and Packages business, and increases in the number of deliveries, particularly Sunday deliveries, partially offset by the impact of attrition of higher paid employees, who were largely replaced by newly converted career employees and non-career employees earning lower wages.

Workforce Composition

The composition of our workforce is a significant factor of our compensation expense. As of September 30, 2017, our career workforce consisted of 503,000 career employees, a reduction of 6,000 career employees from the previous year. Our overall workforce consisted of approximately 644,000 career and non-career employees, an increase of 4,000, or 0.6%, compared to the prior year. This increase is the result of an increase in non-career employees. Beginning in 2013, our labor contracts permitted us to use more non-career employees, allowing us to replace career work hours with non-career work hours at reduced rates and to support the continuing growth in our Shipping and Packages business and the continuing growth in the delivery network.

The number of total employees increased 18,000, or 2.9%, between 2016 and 2015. This increase was the result of an increase in career employees needed to support the continuing growth in our Shipping and Packages business, primarily Sunday deliveries, and the continuing growth in the number of delivery points.

During 2017 and 2016, we converted approximately 28,000 and 44,000 employees, respectively, from non-career to career status, as dictated by our operational needs and contractual provisions. These conversions were necessary to offset attrition of career employees, primarily through retirement. Although career employees are more costly than non-career, these converted employees represent a significant savings relative to the career employees they replace who were compensated on a higher wage scale.

The following table provides the totals of career and non-career employees as of September 30, 2017, 2016 and 2015:

	2017	2016	2015
Career employees	503,000	509,000	492,000
Non-career employees	141,000	131,000	130,000
Total employees	**644,000**	**640,000**	**622,000**

Work Hours

Work hours are an important component of compensation expense. During the year ended September 30, 2017, total work hours increased by approximately 6 million, or 0.5%, compared to 2016. During the year ended September 30, 2016, total work hours increased by approximately 30 million, or 2.6%, compared to 2015. These increases were influenced by the growth in the number of delivery points and the growing Shipping and Packages volume. The number of delivery points increased by approximately 1.2 million in 2017, and 1.1 million in 2016. The lower rate of growth in work hours compared to the work-hour growth in 2016 can also be explained by lower *First-Class Mail* and *Marketing Mail* volumes.

Collective Bargaining Agreements and Non-bargaining Salaries

As indicated previously in this report, as of September 30, 2017, approximately 92% of our career employees are covered by collective bargaining agreements. The contracts with the four labor unions representing the majority of our employees include provisions granting annual increases and COLAs, which are linked to the CPI-W.

In 2015, employees represented by the APWU and NRLCA received a 1.0% general wage increase, and employees represented by the NALC and NPMHU received a 1.5% general wage increase. Employees represented by the APWU, NALC, NRLCA and NPMHU did not receive COLAs in 2015.

In April 2016, we reached a new three-year collective bargaining agreement with the NRLCA which was ratified by the NRLCA membership. The new contract includes general wage increases totaling 3.8% over the life of the contract (1.2% of which was retroactive to November 2015) with a COLA base month of July 2014 (no retroactive COLA payments), a reduction in the employer share of health insurance premiums, beginning in the 2017 plan year, and the creation of a new non-career employee category to provide weekend and holiday parcel deliveries. The contract will expire on May 20, 2018.

In July 2016, an interest arbitration decision was issued that resulted in an award which established a collective bargaining agreement between the APWU and us. The award, which will expire on September 20, 2018, was the result of a legally-mandated binding arbitration process that is required when the parties reached impasse in negotiating a new collective bargaining agreement after the prior agreement expired in May 2015. The contract includes general wage increases totaling 3.8% over the life of the contract (1.2% of which was retroactive to November 2015) with a COLA base month of July 2014 (no retroactive COLA payments), a reduction in the employer share of health insurance premiums, beginning in the 2017 plan year, and annual increases in uniform and work clothes allowances. The award also converted approximately 5,000 non-career positions to career positions.

In December 2016, we reached a tentative agreement with the NPMHU on a new 40-month labor contract (retroactive to May 2016) which was subsequently ratified by the union membership in February 2017. The new contract includes general wage increases totaling 3.8% over the life of the contract (1.2% of which was retroactive to November 2016) with a COLA base month of July 2014 (the first COLA payment was retroactive to September 2016), a reduction in the employer share of health insurance premiums beginning in the 2018 plan year, and annual increases in uniform and work clothing allowances. The contract will expire on September 20, 2019.

In May 2017, we reached a tentative agreement with the NALC on a new 40-month labor contract (retroactive to May 2016) which was subsequently ratified by the union membership in August 2017. The new contract includes general wage increases totaling 2.5% over the life of the contract (1.2% of which was retroactive to November 2016) with a COLA base month of July 2014 (the first COLA payment was retroactive to September 2016), a November 2018 consolidation of the current two pay grades into a single pay grade, a reduction in the employer share of health insurance premiums beginning in the 2018 plan year, and annual increases in uniform and work clothing allowances. The contract will expire on September 20, 2019.

Annual salary increases for non-bargaining unit employees only occur through a Pay-For-Performance ("PFP") system. With only minor exceptions, no COLA or locality pay programs apply to non-bargaining unit employees. PFP salary increases averaged 2.1% for 2014 (implemented in January 2015), 1.6% for 2015 (implemented in January 2016), and 2.9% for 2016 (implemented in January 2017).

FERS Employees' Current Year Service

Our expense for FERS employees' current year service consists of FERS normal cost, Social Security and TSP contributions, and is reported within *Compensation and benefits* under *Operating expenses* in the accompanying *Statements of Operations*. We record our contributions to FERS, Social Security and TSP as an expense in the period during which the contribution is due. We recognize the expense for each period's legally required contribution, and record a liability for any contribution due and unpaid at the end of each reporting period. The cost of unfunded FERS retirement benefits is reported separately within *Unfunded retirement benefits* in the accompanying *Balance Sheets*, as discussed below. For additional information, see *Item 8. Financial Statements and Supplementary Data*, *Notes to Financial Statements*, *Note 10 - Retirement Plans*.

The following table presents the components of FERS employees' current year service as included within *Compensation and benefits* for the years ended September 30, 2017, 2016 and 2015:

(in millions)	2017	2016	2015
FERS normal costs	$ 3,474	$ 3,436	$ 3,258
Social security	2,039	2,009	1,956
TSP	1,091	1,064	1,025
Total FERS employees' current year service	**$ 6,604**	**$ 6,509**	**$ 6,239**

For the year ended September 30, 2017, FERS normal costs increased 1.1%. As most of our employees participate in FERS, this increase was consistent with the increase in compensation for the year, described above in *Compensation*. Our employer normal cost contribution rate was unchanged at 13.7% of basic pay for most employees who participated in FERS during 2017.

For the year ended September 30, 2016, FERS normal costs increased 5.5%. This increase was largely the result of the increase in compensation expense, attributable to the increase in our employer normal cost contribution rate from 13.2% to 13.7% of basic pay for most employees who participated in FERS. This rate increase became effective October 1, 2015, and increased our annual FERS normal cost by approximately $125 million for the year ended September 30, 2016. To a lesser extent, contractually-obligated salary escalations and growth in the number of employees and work hours also contributed to the increase in FERS normal costs.

Employee Health Benefits

Our expense for employee health benefits is most significantly impacted by the number of employees electing coverage and the premium costs of the selected plans. Our active employees may participate in FEHB, which is administered by OPM. We account for employee benefit costs as an expense in the period in which our contributions to the plans under the program are due. Average premium increases were 4.4% in 2017, 3.8% in 2016 and 3.2% in 2015. OPM has announced that average premiums will rise by 4.0% for 2018. The estimated increase in Postal Service employer premium contributions is approximately 1.5%. This will vary based on the actual plans selected by employees during open enrollment season.

Employee health benefits expense was $5.2 billion for the year ended September 30, 2017, a 3.8% increase over 2016. For the year ended September 30, 2016, the expense was $5.0 billion, a 4.1% increase compared to the 2015 expense of $4.8 billion.

Our employer contribution rates for the majority of our employees are subject to collective bargaining agreements. Our share of healthcare premiums for employees represented approximately 74%, 74% and 75% of premiums for 2017, 2016 and 2015, respectively. Employee health benefits expense was 10.5%, 10.3% and 10.1% of total compensation and benefits expense for the years ended September 30, 2017, 2016 and 2015, respectively.

CSRS and FERS Unfunded Retirement Benefits

OPM periodically notifies us regarding its revaluation of unfunded CSRS and FERS retirement benefits. OPM calculates these obligations using government-wide salary growth and demographic data, rather than Postal Service-specific demographics and salary growth assumptions. In October 2017, OPM issued a new rule announcing their intent to calculate future unfunded retirement FERS obligations using Postal Service-specific demographic assumptions. The new rule did not address all of our concerns regarding the use of government-wide versus Postal Service-specific demographic and wage growth assumptions.

We record the expenses for our unfunded CSRS and FERS liabilities as *Unfunded retirement benefits* in the accompanying *Statement of Operations*. These amounts may be significantly impacted by changes in actuarial assumptions used to revalue the unfunded liabilities.

The following table presents the cost of CSRS and FERS unfunded retirement benefits for the years ended September 30, 2017, 2016 and 2015:

(in millions)	2017	2016	2015
CSRS unfunded retirement benefits	$ 1,741	$ —	$ —
FERS unfunded retirement benefits	917	248	241
Total cost of CSRS and FERS unfunded retirement benefits	**$ 2,658**	**$ 248**	**$ 241**

The Board of Actuaries of the Civil Service Retirement System ("Board of Actuaries") makes recommendations regarding the interest, salary inflation, cost-of-living-adjustment ("COLA") and investment return rate assumptions used to determine the funded status of both CSRS and FERS. On June 1, 2017, the Board of Actuaries updated these actuarial assumptions.

We received an invoice from OPM in the amount of $1.7 billion for the first annual CSRS unfunded benefits payment under PAEA due September 30, 2017. We received an invoice from OPM in the amount of $917 million for our 2017 FERS unfunded benefits payment. These invoiced amounts for both CSRS and FERS unfunded liabilities, which we recorded as expenses, were significantly higher than what OPM had previously estimated due, in large part, to the Board of Actuaries' revised assumptions. As discussed elsewhere in this report, we determined that we would not be able to make these payments due September 30, 2017, in order to preserve adequate liquidity to ensure that we would be able to continue to fulfill our primary universal service mission.

We believe that, even with OPM's decision to use Postal Service-specific demographic assumptions in future actuarial valuations, the OPM methodology unfairly increases our present and future costs because it fails to consider the Postal Service's lower rate of salary growth. Experience over the past decade demonstrates that average salary increases of our employees are lower than the government-wide estimates that OPM currently uses. As described elsewhere in this report, OPM calculated that our portion of the FERS plan was underfunded by $15.3 billion as of September 30, 2016. We continue to request that OPM reconsider its use of such government-wide economic factors and instead apply both Postal Service-specific economic and demographic assumptions, which we believe would have resulted in a reduction in the unfunded liability of approximately $4.5 billion as of September 30, 2016, the most recent period in which such comparisons have been calculated.

In addition to OPM's use of government-wide statistics to calculate our liability and contribution rates to the plans, we are subject to the following constraints and risks that would otherwise not apply with a Postal Service-specific structure:

- Assets contributed to the plans by a single participating U.S. government employer may be used to provide benefits to employees of other participating employers.
- If a participating U.S. government employer ceases contributing to a plan, any unfunded obligations of the plan may be borne by the remaining participating employers.
- Federal law mandates our participation in the plans. If a change in the law permitted us to discontinue this participation, we may be required to contribute to the discontinued plan(s) an amount based on any underfunded status, referred to as a withdrawal liability, if such a liability exists at that time.

Funded Status

OPM administers the CSRS and FERS plans via the Civil Service Retirement and Disability Fund ("CSRDF"). Although CSRDF is a single fund that does not maintain a separate account for each participating U.S. government employer, PAEA requires certain disclosures regarding obligations and changes in net assets as if the funds were separate. Such disclosures, which are presented below, are based solely on information provided to us by OPM. Because CSRS and FERS are not subject to the rules and regulations of the *Pension Protection Act of 2006*, typical plan measurements such as zone status and financial improvement plan status, or rehabilitation plan status are not available for these plans.

For 2015, the most current period available, we provided more than 5% of the total plan contributions for FERS from all employers (as disclosed in OPM's *Civil Service Retirement and Disability Fund Annual Report*). According to OPM, our portion of the FERS liability had been overfunded from 1992 through the year ended September 30, 2012, when our estimated surplus was approximately $900 million. Because of revisions to OPM's government-wide economic and demographic assumptions, this surplus reversed to a deficit of $15.3 billion and $3.8 billion for the years ended September 30, 2016, and 2015, respectively.

As a result of the deficit, OPM calculated an amortization schedule to pay down the FERS deficit over 30 years, and, accordingly, billed us $917 million, $248 million and $241 million for 2017, 2016 and 2015, respectively. Likewise, in accordance with the provisions of the PAEA, OPM calculated an amortization schedule to pay down the CSRS deficit over 30 years, and, accordingly, billed us $1.7 billion for 2017. As noted above, none of these amounts were paid and all are included within *Unfunded retirement benefits* in the accompanying *Balance Sheets*.

Each October, OPM provides us with an actuarial report prepared for the purpose of providing financial reporting information with respect to our CSRS and FERS pension obligations, in accordance with PAEA requirements. The actuarial report contains information regarding: 1) the funded status of our CSRS and FERS pension obligations; 2) components and analysis of net change in actuarial liabilities and fund balances for CSRS and FERS; 3) cost methods and assumption underlying actuarial valuations; and 4) actual and estimated contributions to and outlays from our accounts for CSRS and FERS.

In its October 2017 report, OPM provides estimated 2017 information for CSRS and FERS in which estimates are rolled-forward from the actual actuarial liability and fund balances as of September 30, 2016. The actual actuarial liability and fund balances as of September 30, 2017, may differ from these rolled-forward estimates, as data will be updated and actuarial assumptions may be revised during the course of the year.

The following table provides OPM's calculations of the funded status of CSRS and FERS for our employees as of September 30, 2017, (estimated), 2016 and 2015, and represents the most recent data available. The actuarial liability presented below represents our share of the CSRS and FERS actuarial liabilities, as estimated by OPM. The fund balance presented below represents contributions made by us to CSRS and FERS, plus a rate of return on such contributions as estimated by OPM.

(in billions)	Estimated[1] 2017	Actual 2016	Actual 2015
CSRS			
Actuarial liability as of September 30	$ 196.0	$ 199.3	$ 194.1
Fund balance[2]	169.7	172.4	177.4
Unfunded	**$ (26.3)**	**$ (26.9)**	**$ (16.7)**
FERS			
Actuarial liability as of September 30	$ 131.9	$ 124.7	$ 109.0
Fund balance[3]	116.2	109.4	105.2
Unfunded	**$ (15.7)**	**$ (15.3)**	**$ (3.8)**
Total CSRS and FERS			
Actuarial liability as of September 30	$ 327.9	$ 324.0	$ 303.1
Fund balance	285.9	281.8	282.6
Unfunded	**$ (42.0)**	**$ (42.2)**	**$ (20.5)**

[1] The most current actual data from OPM is as of September 30, 2016. The estimated information for 2017 was provided by OPM, but is subject to change when final 2017 information is provided later in 2018.

[2] The CSRS estimated fund balance assumes we made the amortization payment due on September 30, 2017. However, no such payment was made.

[3] The FERS estimated fund balance assumes we made the amortization payment due on September 30, 2017. However, no such payment was made. The balance is estimated based on the fund balance as of September 30, 2016, as provided by OPM, which does not include the unpaid amortization payments due on September 30, 2016, 2015 and 2014, respectively.

We have reported this information based on the same valuations that are used by the Civil Service Retirement System Board of Actuaries ("Board of Actuaries") to establish the normal cost and funding requirements for the plans. OPM actuarial valuations utilize the long-term economic assumptions established by the Board of Actuaries. These assumptions are prepared for U.S. government employers as a whole and based upon assumptions from government-wide employee demographics, rather than those specific to our workforce.

The following table provides plan assets, accumulated benefit obligations, the unfunded actuarial liability amounts and percentage funded for both the CSRS and FERS retirement plans both government-wide, as published in OPM's *Civil Service Retirement and Disability Fund Annual Report* (dated February 2017), and for the Postal Service for the year ended September 30, 2015, the date of the most recent available information:

($ in billions)	U.S. Government	Postal Service	Postal Service as a % of the U.S. Government
CSRS:			
Plan assets	$ 316.8	$ 177.4	56.0%
Accumulated benefit obligations	1,056.4	194.1	18.4%
Unfunded actuarial liability	$ (739.6)	$ (16.7)	
% Funded	30.0%	91.4%	
FERS:			
Plan assets	$ 556.5	$ 105.2	18.9%
Accumulated benefit obligations	606.5	109.0	18.0%
Unfunded actuarial liability	$ (50.0)	$ (3.8)	
% Funded	91.8%	96.5%	

When CSRS and FERS data for the Postal Service were excluded from the 2015 data for U.S. government employers, taken as a whole, the CSRS plan was less than 17% funded, while the FERS plan was approximately 91% funded. This is because the Postal Service funding of CSRS and FERS was greater than 91% and 96%, respectively.

Cost Methods and Assumptions

The Board of Actuaries recommended revisions to certain government-wide demographic assumptions including additional future mortality improvement, effective for the September 30, 2016, valuation. The following table details the long-term economic assumptions recommended by the Board of Actuaries in July 2013, and revised in June 2017:

	2017		**2016**		**2015**	
	CSRS	**FERS**	**CSRS**	**FERS**	**CSRS**	**FERS**
Rate of inflation	2.50%	2.50%	3.00%	3.00%	3.00%	3.00%
Long-term COLA	2.50%	2.00%	3.00%	2.40%	3.00%	2.40%
Actual COLA applied	0.30%	0.30%	0.00%	0.00%	1.70%	1.70%
Long-term salary increase	2.75%	2.75%	3.25%	3.25%	3.25%	3.25%
Actual salary increase	2.10%	2.10%	1.30%	1.30%	1.00%	1.00%
Long-term interest rate	4.50%	4.50%	5.25%	5.25%	5.25%	5.25%

Net Periodic Costs

The following, provided by OPM, details the changes in our estimated actuarial liability for CSRS and FERS as of September 30, 2017, (estimated) and 2016, and represents the most recent data available:

(in billions)	**Estimated[1] 2017**	**Actual 2016**
CSRS		
Actuarial liability as of October 1	$ 199.3	$ 194.1
+ Contributions[2]	0.1	0.1
- Benefit disbursements	(12.1)	(12.2)
+ Interest expense	8.7	9.9
+ Net actuarial gain	—	7.4
Actuarial liability as of September 30	**$ 196.0**	**$ 199.3**
FERS		
Actuarial liability as of October 1	$ 124.7	$ 109.0
+ Normal costs	4.4	3.7
- Benefit disbursements	(2.8)	(2.6)
+ Interest expense	5.6	5.8
+ Net actuarial gain	—	8.8
Actuarial liability as of September 30	**$ 131.9**	**$ 124.7**
Total actuarial liability as of September 30	**$ 327.9**	**$ 324.0**

[1] The most current actual data from OPM is as of September 30, 2016. The estimated information for 2017 was provided by OPM, but is subject to change when final 2017 information is provided later in 2018.

[2] Contributions for CSRS consist of employee contributions only.

Components of Net Change in Plan Assets

As described above, CSRDF is a single fund and does not maintain separate accounts for CSRS and FERS or for individual U.S. government employers. The investment holdings of the CSRDF consist entirely of long-term special-issue U.S. Treasury securities with maturities of up to 15 years. The long-term securities bear interest rates ranging from 1.38% to 5.13%.

The assumed rate of return on the CSRS fund balance was 4.50% for 2017 and 5.25% for 2016, and the actual rates of return were 4.10% and 4.04%, respectively. For the FERS fund, the assumed rate of return was 4.50% for 2017 and 5.25% for 2016, while the actual rates of return were 2.95% and 3.04%, respectively. The projected long-term rate of return for both the CSRS and FERS fund balances for 2017 was 4.50%.

The following table details OPM's 5-year estimates for our CSRS and FERS contributions (both employee and employer), unfunded liability amortization payments and benefit payments:

(in billions)	CSRS			
Year	**Employee contributions**	**USPS contributions**	**Amortization payments**	**Total benefit payments**
2018	$ 0.1	$ —	$ 1.7	$ 12.3
2019	0.1	—	1.7	12.4
2020	0.1	—	1.7	12.6
2021	0.1	—	1.7	12.7
2022	0.1	—	1.7	12.7
	FERS			
Year	**Employee contributions**	**USPS contributions**	**Amortization payments**	**Total benefit payments**
2018	$ 0.4	$ 3.4	$ 0.9	$ 3.2
2019	0.4	3.3	0.9	3.6
2020	0.4	3.8	0.9	4.1
2021	0.4	3.7	0.9	4.5
2022	0.4	3.6	0.9	5.0

The following information, provided by OPM, details the components of the net change in our estimated portion of plan assets for CSRS and FERS for the years ended September 30, 2016, and 2015, and represents the most recent data available:

(in billions)	**Actual 2016**	**Actual 2015**
CSRS		
Net assets as of October 1	$ 177.4	$ 182.4
+ Contributions	0.2	0.2
- Benefit disbursements	(12.2)	(12.3)
+ Investment income	7.0	7.1
CSRS net assets as of September 30	**$ 172.4**	**$ 177.4**
FERS		
Net assets as of October 1	$ 105.2	$ 100.9
+ Contributions	3.7	3.5
- Benefit disbursements	(2.6)	(2.3)
+ Investment income	3.1	3.1
FERS net assets as of September 30	**$ 109.4**	**$ 105.2**

Retiree Health Benefits

Retirees who participated in FEHB for the five years immediately preceding their retirement may continue to participate in the plan during retirement. Qualifying survivors of retirees are also eligible to receive benefits. Under PAEA, we are obligated to fully fund the PSRHBF for the estimated employer's portion of the established health benefits of retirees and our current employees. Our total cost for retiree health benefits in 2017 consists of two components: 1) the normal cost of the estimated retirement health benefits of active career employees, and 2) the amortization of the unfunded liability. We recognize an expense when the payment is due. Our total cost for retiree health benefits consisted of two different components in 2016: 1) our portion of the current premium expense for beneficiaries, and 2) the legally-mandated PSRHBF prefunding payments, which we recognized as an expense when due.

In addition to changes in premium amounts each year, several other factors could significantly affect our future retiree health benefits expenses, including investment performance of the PSRHBF, changes in demographics, changes in actuarial assumptions and increased or decreased benefits to participants. See *Item 8. Financial Statements and Supplementary Data*, *Notes to Financial Statements*, *Note 11 - Health Benefits Plans*, *Retiree Health Benefits* for additional information.

Normal Costs and Retiree Health Benefits Premiums

In accordance with PAEA, beginning in 2017, the PSRHBF began funding our share of retiree health benefit premiums, and we were obligated to begin paying into the PSRHBF the normal costs of retiree health benefits attributable to the service of our current employees. We received an invoice from OPM in the amount of $3.3 billion for normal costs that we were obligated to pay by September 30, 2017. We did not make this payment in order to preserve liquidity and to ensure that our ability to fulfill our primary universal service mission was not placed at undue risk.

Retiree health benefits premium expense, which we were required to pay until 2017, increased $194 million, or 6.2%, for the year ended September 30, 2016, compared to the prior year.

The number of retiree health beneficiaries was approximately 486,000, 487,000, and 489,000 for the years ended September 30, 2017, 2016 and 2015, respectively.

PSRHBF Funded Status

OPM valuations of post-retirement health liabilities and normal costs were prepared in accordance with Federal Accounting Standards Advisory Board Statement of Federal Financial Accounting Standards (“SFFAS”) No. 5 and SFFAS No. 33, which require the use of the aggregate entry age normal actuarial cost method. Demographic assumptions are consistent with the pension valuation assumptions, but decrements are based upon counts or number rather than dollars.

The following information, provided by OPM, details the PSRHBF funded status. The fund balance and the unfunded obligation presented below do not include amounts invoiced but not paid to the PSRHBF of $38.2 billion and $33.9 billion through September 30, 2017, and 2016, respectively.

(in millions)	2017	2016
Beginning actuarial liability at October 1	$ 103,981	$ 105,162
+ Actuarial loss (gain)	4,020	(4,555)
+ Normal costs	3,489	2,755
+ Interest at 4.8% and 3.9%, respectively	3,996	3,924
Subtotal net periodic costs	$ 11,505	$ 2,124
- Premium payments	(3,431)	(3,305)
Actuarial liability at September 30	$ 112,055	$ 103,981
- Fund balance at September 30	(49,808)	(51,862)
Unfunded obligations at September 30	**$ 62,247**	**$ 52,119**

The determination of the liability assumes a single discount rate of 3.7% equivalent to the most recent ten year historical average yield curve. The normal cost, which is on a per-participant basis, is computed to increase annually by a variable medical inflation rate which is assumed to be 4.9% per annum as of the valuation date, grading down to an ultimate value of 3.4% in 2075. Past-year medical inflation was assumed to be 5.5%. Normal costs are derived from the current FEHB on-rolls population with an accrual period from entry into FEHB to assumed retirement. The amounts and variables used to determine the liability are the same the assumptions used under OPM’s methodology, except that the average government share of premium payments for annuitants is substituted for annuitant medical costs less annuitant premium payments.

Because the calculation of the PSRHBF liability involves several areas of judgment, estimates of the liability could vary significantly depending on the assumptions used. Utilizing the same underlying data that was used in preparing the estimate in the table above, the September 30, 2017, unfunded obligation could range from $47 billion to $81 billion, solely by varying the inflation rate by plus or minus 1%, and the September 30, 2016 unfunded obligation would range from $39 billion to $68 billion. If the actuarial liability had been calculated using the Board of Actuaries long-term rate assumption of 4.50%, the liability would have been approximately $100 billion, or 11% lower, as of September 30, 2017, and approximately $86 billion, or 17% lower, as of September 30, 2016.

For our current annuitants, the government share of premium payments is adjusted to reflect the pro rata share of civilian service to total service for which we are responsible. The pro rata adjustment is made by applying calculated factors based upon actual payments that vary by the age and Medicare status of enrollees. For our active employees, the pro-rata share in retirement is assumed to be 95% of the total.

PSRHBF assets are comprised entirely of long-term, special-issue U.S. Treasury securities with maturities of up to 15 years bearing interest rates from 1.38% to 5.0%. The following table details the fund balance, including interest receivable, of the PSRHBF, as reported by OPM:

(in millions)		2017		2016
Beginning balance (including interest receivable) at October 1	$	51,862	$	50,345
Contributions and transfers		—		—
Earnings at 2.8% and 3.1%, respectively		1,396		1,517
Payments for annuitant premiums*		(3,450)		—
Net (decrease) increase	$	(2,054)	$	1,517
Fund balance (including interest receivable) at September 30	**$**	**49,808**	**$**	**51,862**

* Includes premium payments for certain annuitant/employees under workers' compensation coverage.

Although PAEA has dictated the PSRHBF prefunding requirements, the amounts and the timing of funding could change at any time with enactment of a new law or an amendment of existing law. The total amount of payments due to the PSRHBF through September 30, 2017, and 2016, was $38.2 billion and $33.9 billion, respectively. In order to preserve liquidity, we did not make the annual payments due on September 30, 2017, for the PSRHBF unfunded liability expense of $955 million or the normal costs of retiree health benefits of $3.3 billion, respectively.

The following information, provided under the PAEA mandate, details OPM's preliminary 5-year estimates for payments into the PSRHBF for normal costs and unfunded liability expenses, and payments out of the PSRHBF for annuitant premiums:

(in billions)	**Estimated payments into the PSRHBF**				**Estimated payments out of the PSRHBF**
Year	**Normal costs**	**Amortization of unfunded liability**	**Payable to PSRHBF**	**Total**	**Annuitant premiums**
2018	$ 3.5	$ 1.0	$ 38.2	$ 42.7	$ 3.7
2019	3.7	1.0	—	4.7	3.9
2020	3.9	1.0	—	4.9	4.1
2021	4.0	1.0	—	5.0	4.4
2022	4.2	1.0	—	5.2	4.7

Workers' Compensation

Our employees who are injured on the job are covered by FECA, administered by the DOL's OWCP, which makes all decisions regarding injured workers' eligibility for benefits. We are legally mandated to participate in the federal workers' compensation program. Additionally, we reimburse the DOL for all workers' compensation benefits paid to or on behalf of our employees.

Under FECA, workers' compensation claims for many types of injuries cannot be settled through lump-sum payments, and in some instances with regard to those claims, compensation may be paid over many years. Federal law grants COLA rates to those claims, and these factors result in substantially higher costs to us than would likely result if we managed our own claims. Additionally, since we do not manage the FECA program, we have no ability to control the significant administrative costs associated with managing the claims and payments process.

Our workers' compensation expense reflects the impacts of changes in discount rates as well as the actuarial valuation of new workers' compensation cases and revaluation of existing ones. The expense also includes an administrative fee paid to DOL. The table below details the components of workers' compensation expense for the years ended September 30, 2017, 2016 and 2015:

(in millions)	2017	2016	2015
Impact of discount rate changes	$ (1,362)	$ 1,026	$ 809
Actuarial revaluation of existing cases	(1,138)	(113)	(886)
Costs of new cases	1,552	1,697	1,767
Administrative fee	151	72	70
Total workers' compensation (benefit) expense	**$ (797)**	**$ 2,682**	**$ 1,760**

For the year ended September 30, 2017, workers' compensation expense provided a benefit of $797 million, compared to an expense of $2.7 billion for the prior year, a net decrease of $3.5 billion. Payments made by DOL on behalf of workers' compensation obligations and the associated administrative fee were $1.4 billion for the year ended September 30, 2017, compared to $1.5 billion for the 2016. For additional information, see *Item 8. Financial Statements and Supplementary Data, Notes to Financial Statements*, *Note 12 - Workers' Compensation*

Impact of Discount Rate Changes

For the year ended September 30, 2017, the portion of workers' compensation expense attributable to the impact of discount rate changes resulted in a net reduction in expenses of $2.4 billion compared to 2016. These changes were the result of increases in discount rates, outside of management's control.

For the year ended September 30, 2016, the portion of workers' compensation expense attributable to the impact of discount rate changes increased $217 million, compared to 2015. These changes were the result of declining discount rates, also outside of management's control.

Actuarial Revaluation of Existing Cases and Costs of New Cases

Changes in actuarial valuation are primarily attributable to the combined impacts of routine changes in actuarial estimation, the progression of existing cases and updated COLA assumptions, which are largely outside of management's control.

For the year ended September 30, 2017, the combined costs of new workers' compensation cases and actuarial revaluation of existing cases decreased $1.2 billion compared to 2016. These cost savings were largely the result of DOL's change in rules for pharmaceutical compounding, discussed in greater detail below, which included a $549 million benefit for the year. This rule change also reduced the cash outlays for compound pharmaceuticals by 97% since the new rules took effect in October 2016.

For the year ended September 30, 2016, the combined costs of new workers' compensation cases and actuarial revaluation of existing cases increased $703 million, compared to 2015. The increase was related to changes in the valuation assumptions associated with COLA, medical trend and compensation severity rates, along with the impact of a first quarter 2015 change in accounting estimate. This one-time change in accounting estimate caused the increase in this portion of workers' compensation expense to be $353 million higher than what it otherwise would have been. We believe the change allows greater flexibility to select factors reflecting the best and most current injury trends and provides the best estimate when determining the actuarial revaluation of existing cases.

Included within the combined costs of new cases and actuarial revaluation of existing cases are costs associated with pharmaceutical compounding, which is the creation of a pharmaceutical product through the combination of various ingredients directly by a pharmacist. In 2013, our compound pharmaceutical costs totaled $9 million. However, in 2016, these costs increased to $173 million, a nineteen-fold increase in only three years. In March 2016, the U.S. Postal Service Office of Inspector General issued a report concluding that those increases were attributable to DOL's failure to control the pharmacy-compound invoicing process. As the report recognized, we had no control over that process, which the DOL exclusively administers.

In October 2015, we formally requested DOL to adjust its annual charge-back invoice and we withheld a $69 million payment for new compound-drug costs. DOL ultimately refused to adjust the bill, and we paid the $69 million. In October 2016, we again formally requested DOL to adjust its annual charge-back invoice and we withheld $151 million from the payment for new compound-drug costs and the associated administrative fee. As of the date of this report, DOL has not issued a credit to us for the requested $151 million withheld from the 2016 invoice, but has agreed to meet with us to discuss the issue.

In July 2016, DOL implemented a new pharmaceutical compounding policy and in October 2016, DOL implemented a "Letter of Medical Necessity" requirement for compound pharmaceuticals. As noted above, largely due to these changes in rules for pharmaceutical compounding, we recorded a $549 million benefit for the year ended September 30, 2017, and have reduced the cash outlays for compound pharmaceuticals by 97% since the new rules took effect in October 2016.

Transportation

Transportation expense includes the costs we incur to transport mail and other products between our facilities, comprising of highway, air and international transportation contracts, plus contract delivery services. Our costs of transportation to delivery points, excluding contract delivery services, are included within *Other operating expenses.* Transportation expenses also do not include the compensation of employees responsible for transporting mail and other products between our facilities.

Variations in the volume and weight of transported mail and the mode of transportation utilized may have a significant impact on our transportation expenses. The table below details the components of transportation expense for the years ended September 30, 2017, 2016 and 2015:

(in millions)	2017	2016	2015
Highway	$ 4,070	$ 3,827	$ 3,638
Air	2,481	2,469	2,151
International	631	642	773
Other	56	54	17
Total transportation expense	**$ 7,238**	**$ 6,992**	**$ 6,579**

Overall, transportation expense increased $246 million, or 3.5%, during the year ended September 30, 2017, compared to the prior year.

Highway transportation expenses increased $243 million, or 6.3%, during the year ended September 30, 2017, compared to the prior year, due largely to the higher price per mile we paid on contract routes, and to a lesser extent, higher diesel fuel prices for the year.

Air transportation expenses increased $12 million, or 0.5%, during the year ended September 30, 2017, compared to the prior year, due to a modest increase in average jet fuel prices for the year, offset slightly by lower air network volume and increased use of lower cost carriers. International transportation expenses, which represent expenses related only to outbound services, decreased slightly, primarily due to a decline in *Priority Mail International* and other international service volumes.

Highway and air transportation expenses increased approximately 5% and 15%, respectively, in 2016 compared to 2015 due to volume growth in our Shipping and Packages business and our strategic efforts to continue to improve our delivery service results. These increased transportation costs were buffered by an approximately 24% reduction in average diesel fuel prices, affecting our highway network, and an approximately 29% reduction in average jet fuel prices, affecting our air network, yielding approximately $170 million and $153 million in annual savings, respectively. International transportation expenses, which represent expenses related only to outbound services, decreased primarily due to a decline in *Priority Mail International* and *Priority Mail Express International* volumes.

Other Operating Expenses

The following table details other operating expenses for the periods ended September 30, 2017, 2016 and 2015:

(in millions)	2017	2016	2015
Supplies and services	$ 2,980	$ 2,755	$ 2,705
Depreciation and amortization	1,677	1,740	1,769
Rent and utilities	1,590	1,560	1,613
Vehicle maintenance service	640	624	617
Delivery vehicle fuel	409	359	436
Information technology and communications	914	852	784
Rural carrier equipment maintenance	503	484	514
Miscellaneous other	1,030	1,057	719
Total other operating expenses	**$ 9,743**	**$ 9,431**	**$ 9,157**

Other operating expenses increased 3.3% in 2017 compared to 2016, driven by increases in supplies and services, delivery vehicle fuel and information technology and communications components. The supplies and services component increased approximately 8% primarily due to an increase in information security services. The delivery vehicle fuel component increased approximately 14% primarily due to increases in average diesel fuel prices. The information technology and communications component increased approximately 7% primarily due to increased commercial software license and maintenance fees.

While most of the components within other operating expenses either declined slightly or remained nearly the same in 2016 compared to 2015, the miscellaneous other component had a more significant increase which led to the overall 3.0% growth of other operating expenses during 2016 compared to 2015.

NON-OPERATING REVENUES AND EXPENSES

Interest and Investment Income

In addition to the income we generate from investments in securities issued by the U.S. Treasury, we record imputed interest on the future installment payments that are owed to us under the *Revenue Forgone Reform Act of 1993* (the "RFA"). Under the RFA, Congress agreed to reimburse us $1.2 billion in 42 annual installments of $29 million each through 2035 for services we performed in prior years. Imputed interest for the future revenue forgone installments was $21 million, $22 million and $22 million for the years ended September 30, 2017, 2016 and 2015, respectively. See *Item 8. Financial Statements and Supplementary Data*, *Notes to Financial Statements*, *Note 13 - Revenue Forgone* for additional information. Investment income was immaterial for the years ended September 30, 2017, 2016 and 2015.

Interest Expense

Interest expense was $226 million, $222 million and $185 million, for the years ended September 30, 2017, 2016 and 2015, respectively. Although long-term debt generally carries higher interest rates than short-term debt, financing a portion of our debt at longer-term fixed rates decreases our interest rate risk and interest expense volatility in subsequent years.

LIQUIDITY AND CAPITAL RESOURCES

We held unrestricted cash and cash equivalents of $10.5 billion and $8.1 billion as of September 30, 2017, and September 30, 2016, respectively. Our average daily liquidity balance during the year ended September 30, 2017, was $9.4 billion, which represents approximately 34 days of liquidity available, which we define as unrestricted cash plus available borrowing capacity divided by estimated average cash disbursements (including capital expenditures) per business day (usually 251 cash disbursement days per year). See *Item 8. Financial Statements and Supplementary Data*, *Notes to Financial Statements*, *Note 2 - Liquidity* for additional information.

CASH FLOW ANALYSIS

Our cash balances have increased by approximately $8 billion from the reported low in 2012. This improvement would not have occurred had the Postal Service not defaulted on the annual PSRHBF prefunding payments from 2012 through 2016, and the RHB normal cost, and RHB, CSRS and FERS amortization payments in 2017. Aside from the defaults, the improvement is largely attributable to the temporary exigent surcharge (discussed in greater detail below) which generated approximately $4.6 billion in incremental revenue from January 2014 through April 10, 2016.

We must maintain adequate liquidity to support our annual operating expenses of $72 billion to make capital investments necessary for continuity of operations and to prepare for unexpected contingencies. As discussed elsewhere in this report, in addition to not making $33.9 billion of PSRHBF prefunding payments, we did not make $6.9 billion in payments due September 30, 2017, for PSRHBF normal cost and amortization on PSRHBF, CSRS and FERS unfunded liabilities, in order to preserve liquidity, and to ensure that our ability to fulfill our primary universal service mission was not placed at undue risk.

We continue to face challenges from the ongoing migration of mail to electronic alternatives, and we are legally limited under current law in how we can price our products and streamline our legacy business model. We are further challenged by onerous payment requirements for legacy retirement and PSRHBF obligations that, barring legislative reform, will continue indefinitely.

Our operations will require significant capital investment over the next few years to modernize and improve our processing and delivery infrastructure and update our delivery fleet in order to continue to meet our statutory obligation to provide prompt, efficient and reliable postal services to the nation. Furthermore, given our inability to raise cash through the issuance of additional debt, we do not have sufficient cash balances to meet all of our existing legal obligations, pay down our debt and make all of the critical investments in our infrastructure that are necessary for operational continuity and that have been deferred in recent years.

Operating Activities

Cash provided by operating activities increased by $1.1 billion, or 39.7%, for the year ended September 30, 2017, compared to the previous year. This increase occurred primarily because we did not pay certain obligations due to OPM as of September 30, 2017, as discussed below.

Our cash balances were not sufficient to pay the normal cost of retirement health benefits of $3.3 billion, and the PSRHBF, CSRS and FERS unfunded liability expenses of $955 million, $1.7 billion and $917 million, respectively, in 2017. In prior years, our cash balances were not sufficient to pay the legally-mandated PSRHBF prefunding payments of $5.8 billion and $5.7 billion that were due by September 30, 2016, and 2015, respectively. Although our cash balances were higher than the respective amounts due, making these payments would have made it impossible to maintain a prudent level of liquidity and to adequately fund our normal operations and necessary capital investments necessary to fulfill our fundamental service mandate. As of September 30, 2017, past due amounts payable to the PSRHBF total $38.2 billion, past due amounts payable to CSRS total $1.7 billion and past due amounts payable to FERS total $1.4 billion (although the CSRS and FERS amounts are under appeal); however, we have incurred no penalties or negative consequences resulting from our inability to make these payments.

Cash provided by operating activities decreased by $143 million, or 5.0%, in 2016, compared to the previous year. As more fully described in *Results of Operations*, our operating revenue increased during the year ended September 30, 2016, as we benefited from a full year of a price increase on certain Market-Dominant services that went into effect in May 2015, and by a price increase on certain Competitive services that went into effect in January 2016. These increases were offset, however, by an increase in cash used for operating expenses and by the expiration of the exigent surcharge on April 10, 2016, which resulted in a price reduction of certain Market-Dominant services from that date forward. Given the volume of our cash activity from operations during 2016, the change in cash provided by operating activities was immaterial.

Exigent Surcharge

As described in *Operating Revenue and Volume*, we collected an exigent surcharge on most Market-Dominant services beginning in January 2014 until it produced incremental revenue of just over $4.6 billion, a figure the PRC determined was lost due to the Great Recession’s suppression of mail volume. This limit was reached on April 10, 2016, and we therefore reduced the prices of applicable Market-Dominant services on that date.

As a result of the expiration of the surcharge, we estimate that our revenue and cash flow for 2017 and 2016 were lower by approximately $2 billion and $1 billion, respectively, than what they otherwise would have been. Going forward without the surcharge, we expect our revenue and cash flow will continue to be significantly reduced from what it otherwise would have been had the surcharge remained in place.

Price Increases
On May 31, 2015, a price increase averaging slightly below the CPI-U price cap of 1.966% took place for certain Market-Dominant services. We estimate this price increase generates $750 million in annualized revenue and cash flow.

On October 16, 2015, we filed a notice with the PRC of our intent to increase certain Competitive services prices by an average of 9.5%. The PRC approved this plan and the increase went into effect on January 17, 2016. We estimate that this price increase generates approximately $1 billion in annualized revenue and cash flow.

On October 12, 2016, we filed a notice with the PRC of our intent to increase prices for certain Market-Dominant services by an average of 0.9%. The PRC approved this plan and the increase went into effect on January 22, 2017. We estimate this price increase generates approximately $430 million in annualized revenue and cash flow.

On October 19, 2016, we filed a notice with the PRC of our intent to increase prices for certain Competitive services by an average of 3.9%. The PRC approved this plan and the increase went into effect on January 22, 2017. We estimate this price increase generates approximately $507 million in annualized revenue and cash flow.

On July 26, 2017, we filed a notice with the PRC of our intent to transfer *First-Class Package Service - Retail* (formerly *First-Class Mail Parcels*) from a Market-Dominant service to a Competitive service and implement an average price increase of 9.9% on that service. The PRC approved this plan and the transfer and increase went into effect on September 3, 2017.

On October 6, 2017, we filed a notice with the PRC of our intent to increase prices for Market-Dominant services by an average of 1.9%. On November 9, 2017, the PRC approved this plan and the increase is scheduled to go into effect on January 21, 2018. We estimate it would generate approximately $655 million in annualized revenue and cash flow.

On October 6, 2017, we filed a notice with the PRC of our intent to increase prices for certain Competitive services by an average of 4.1%. On November 7, 2017, the PRC approved this plan and the increase is scheduled to go into effect on January 21, 2018. We estimate this price increase will generate approximately $356 million in annualized revenue and cash flow.

Ten-year Review
On December 20, 2016, the PRC commenced the ten-year review of its system for regulating rates and classes for Market-Dominant products as required by the PAEA. The objective of the review is to determine if the system for regulating rates and classes for Market-Dominant services is achieving the objectives established by Congress in the PAEA. As part of this review, the PRC will evaluate, among other items, the rate cap for our Market-Dominant services. The outcome of this review may affect our future pricing.

Investing Activities
In 2017, we invested $1.3 billion in the purchase of property and equipment, a decrease of $84 million from 2016. In 2016, we invested $1.4 billion in the purchase of property and equipment, an increase of $206 million over 2015.

Our capital expenditures have declined from an annual average of approximately $1.5 billion in years 2009 through 2011 to an annual average of approximately $1.3 billion in years 2015 through 2017, a reduction of approximately 10%. However, we will need to increase our capital expenditures in order to address our aging facilities and delivery fleet and to upgrade our equipment to remain competitive in the marketplace and to ensure that we will be able to continue to meet our statutory obligation to provide prompt, efficient and reliable postal services to the nation. The source of funds needed to fulfill these commitments has been generated from our operating activities and defaults on certain retirement and retiree healthcare obligations, as we have not raised capital through the net increase in debt since September 2012.

We assign priority to proposed capital investments based on the following factors:

1. Needed for safety and/or health or legal requirements;
2. Required to provide service to our customers; and
3. Initiatives with a high return on investment and a short payback period.

Our delivery fleet includes approximately 146,000 vehicles that are at least 20 years old and need significant maintenance to continue in service. As a result, repair and maintenance costs have risen significantly in recent years. We purchased approximately 9,000 new vehicles to add to our fleet during the year ended September 30, 2017. Additionally, we are investing in upgrades of letter sorting equipment that is at or near the end of its useful life, and also investing in sorting and handling equipment to fully capitalize on business opportunities in the growing package delivery market. To conserve cash, we have deferred facilities maintenance in instances where this could be done without adversely impacting employee health or safety.

Financing Activities

As an "independent establishment of the Executive Branch of the Government of the United States," we receive no tax dollars for ongoing operations and have not received an appropriation for operational costs since 1982. We fund our operations chiefly through cash generated from operations and by borrowing from the Federal Financing Bank ("FFB"), a government-owned corporation under the general supervision of the Secretary of the Treasury. See *Item 8. Financial Statements and Supplementary Data*, *Notes to Financial Statements*, *Note 8 - Debt* for additional information.

We have not increased our debt since September 2012, when we reached the maximum borrowing amount allowed under our statutory debt ceiling. Our debt consists of fixed-rate notes and two revolving credit facilities with various maturities with an aggregate principal balance of $15.0 billion as of September 30, 2017, and September 30, 2016. As of September 30, 2017, the current portion of our debt was $10.1 billion, and the noncurrent portion was $4.9 billion.

Within our current portion of debt, the two revolving credit facilities have interest rates determined by the U.S. Department of Treasury each business day and enable us to draw up to $4.0 billion in total. As of September 30, 2017, and September 30, 2016, these facilities were fully drawn and are included in the current portion of debt in the accompanying *Balance Sheets*. The facilities currently have maturity dates in April 2018.

Net cash used in financing activities, for the periods ended September 30, 2017, 2016 and 2015 were $63 million, $51 million and $62 million, respectively, consisting primarily of cash payments on capital lease obligations.

LIQUIDITY OUTLOOK

With the anticipated continued migration to electronic communication and transactional alternatives, we continue to pursue legislation to reform our business model and streamline our burdensome regulatory structure. Such changes might include the adoption of Postal Service-specific economic and demographic assumptions for calculating our pension liabilities, restoring a portion of the exigent rate surcharge by making it a part of our rate base, and giving us some additional product and pricing flexibility.

Additionally, reform is needed to establish a set of healthcare plans within FEHB that would fully integrate with Medicare for current and future retirees. We believe such reform would make our retiree health benefits system affordable by largely eliminating the unfunded liability previously noted. Although we continue to inform the Administration, Congress, the PRC and other stakeholders of the immediate and long-term financial challenges we face, we have no assurances that our requests will result in meaningful reform in the foreseeable future.

2018 and Beyond

The following table provides details of estimated future cash obligations as of September 30, 2017:

(in millions)	Total	Less than 1 year	1-3 years	3-5 years	After 5 years
Debt[1]	$ 15,000	$ 10,100	$ 2,700	$ 1,000	$ 1,200
Interest on debt[1]	1,243	178	207	111	747
CSRS unfunded benefits[2]	46,936	3,477	3,478	3,480	36,501
FERS unfunded benefits[3]	27,505	2,330	1,834	1,834	21,507
PSRHBF unfunded liability[4]	38,200	1,910	1,910	1,910	32,470
PSRHBF fixed payment and normal cost defaults[5]	37,205	37,205	—	—	—
Workers' compensation[6]	25,509	1,525	2,899	3,099	17,986
Capital lease obligations	261	70	97	42	52
Operating leases	7,616	829	1,551	1,347	3,889
Capital commitments[7]	1,172	874	298	—	—
Purchase obligations[7]	6,939	1,334	2,252	1,678	1,675
Employees' leave[8]	2,049	131	229	213	1,476
Total commitments	**$ 209,635**	**$ 59,963**	**$ 17,455**	**$ 14,714**	**$ 117,503**

[1] For overnight and short-term debt, the table assumes the balance as of period end remains outstanding for all periods presented.

[2] Represents OPM's calculation of undiscounted annual payments for amortization of the unfunded liability that we are obligated to pay through 2043.

[3] Represents OPM's calculation of undiscounted annual payments for amortization of the unfunded liability that we are obligated to pay through 2046.

[4] Represents OPM's calculation of undiscounted annual payments for amortization of the unfunded liability that we are obligated to pay through 2056.

[5] Represents the cumulative annual prefunding payments to the PSRHBF between 2012 and 2016, and the normal cost payment invoiced in 2017, all of which the Postal Service defaulted on. OPM considers the defaulted amounts to be due and payable, and the Postal Service continues to reflect these amounts as a current liability within *Retiree health benefits* in the accompanying *Balance Sheets*.

[6] Represents the undiscounted expected future workers' compensation payments plus $103 million in administrative fees, of which $84 million was due October 15, 2017, and assumes no new cases in future years. The obligation to pay administrative fees in future years as determined by DOL is currently not estimated.

[7] Capital commitments pertain to purchases of equipment, building improvements and vehicles for legally binding obligations. Purchase obligations pertain to items that are expensed when received or amortized over a short period of time. These are not reflected on the accompanying *Balance Sheets*.

[8] Employees' leave includes both annual and holiday leave.

As discussed above, our obligations pertaining to CSRS changed in 2017 and OPM now determines the amount of annual payments we will need to make to amortize the CSRS unfunded liabilities. We estimate this payment obligation, which was $1.7 billion in 2017, will continue at approximately that amount annually going forward to 2043. Additionally, our FERS obligation was $917 million in 2017, and we estimate approximately that amount will continue annually going forward to 2046.

Also in 2017, our retiree health benefit obligations changed according to law. The PSRHBF began funding our share of retiree health benefit premiums, and we were to begin paying into the PSRHBF the normal costs of retiree health benefits, which was $3.3 billion and payable on September 30, 2017. OPM estimates that the RHB normal cost will increase by approximately $200 million per year for the next five years. Additionally, OPM will determine the amount of annual payments we will need to make to amortize the PSRHBF unfunded liabilities, which was $955 million in 2017. Based on OPM's 5-year estimate for payments into the PSRHBF for amortization of unfunded liability expenses, we expect the annual obligation will continue at that amount going forward.

We also estimate that our cash outlays for capital assets will amount to $1.8 billion in 2018 and an additional $9.4 billion for the periods of 2019 through 2022. Although our future projections include these capital cash outlays, future cash flow from operations alone may not generate the cash needed for such necessary capital expenditures.

Contingency Plans
Our status as an independent establishment of the executive branch that does not receive tax dollars for our operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With annual revenue of approximately $70 billion, generated almost entirely through the sale of postal services, a financially-sound Postal Service continues to be vital to U.S. commerce. The U.S. economy benefits greatly from the Postal Service and the many businesses that provide the printing and mailing services that we support, and disruption of the mail would cause undue hardship to businesses and consumers.

In the event that circumstances leave us with insufficient cash, we would be required to implement additional contingency plans to ensure that mail deliveries continue. These measures may require us to prioritize payments to our employees and suppliers ahead of some payments to U.S. government entities, as has been done in the past. Without structural change to our business model and legislative change, the factors discussed above will continue to negatively impact us resulting in continuing losses and liquidity challenges for the foreseeable future.

LEGISLATIVE UPDATE

As a self-supporting independent establishment of the executive branch, our business model and operations are significantly influenced by congressional oversight and legislation. Additionally, we are governed by an eleven-member Board which generally consists of our Postmaster General, Deputy Postmaster General and nine independent Governors. The Governors are appointed by the President with the advice and consent of the Senate.

APPROPRIATIONS
On September 8, 2017, the House passed and the President signed into law H.R. 601 (P.L. 115-56), the *Continuing Appropriations Act, 2018* and *Supplemental Appropriations for Disaster Relief Requirements Act, 2017*, to keep the government operating through December 8, 2017. The stopgap measure continues government funding at 2017 levels reduced by 0.68% for most programs and activities, and continues the six-day mail delivery mandate.

POSTAL SERVICE REFORM
As previously reported, the House Oversight and Government Reform Committee approved H.R. 756, the *Postal Service Reform Act of 2017*. The core provisions of the bipartisan measure would institute separate, Postal Service-only plans within FEHB that are fully integrated with Medicare, require Postal Service-specific demographic and economic assumptions in calculating pension liabilities, reinstate half of the exigent surcharge and authorize the provision of non-postal services to state, local and tribal governments. The measure would also reduce the number of Governors from nine to five. H.R. 756 now awaits action by the House Ways and Means Committee and Energy and Commerce Committee.

BOARD OF GOVERNORS
We are governed by an eleven-member Board which generally consists of our Postmaster General, Deputy Postmaster General and nine independent Governors. The Governors are appointed by the President with the advice and consent of the Senate. We currently have no Governors.

On October 30, 2017, the President nominated the following three individuals to serve as Governors on our Board:

- Calvin R. Tucker, to serve the remainder of a term expiring December 8, 2023;
- Robert M. Duncan, to serve the remainder of a seven-year term expiring December 8, 2018, and an additional term expiring December 8, 2025; and
- David Williams, to serve the remainder of a seven-year term expiring December 8, 2019.

The process of obtaining Senate confirmation of these nominees is in its earliest stage.

FAIR VALUE MEASUREMENTS

We did not have any recognized gains as a result of fair valuation measurements in the years ended September 30, 2017, 2016 and 2015. All recognized losses have been incorporated into our financial statements and the unrecognized gains and losses are not considered to have a significant impact upon our operations. See *Item 8. Financial Statements and Supplementary Data*, *Notes to Financial Statements*, *Note 14 - Fair Value Measurement* for additional information.

RELATED PARTY TRANSACTIONS

We have significant transactions with other U.S. government entities, which are considered related parties for reporting purposes. See *Item 8. Financial Statements and Supplementary Data*, *Notes to Financial Statements*, *Note 3 - Related Parties*

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The preparation of financial statements in accordance with GAAP requires management to make significant judgments and estimates to develop certain amounts reflected and disclosed in the financial statements. In many cases, alternative policies or estimation techniques may be used.

We maintain a thorough process to review the application of accounting policies and to evaluate the appropriateness of the many estimates that are required to prepare the financial statements. Management discusses the development and selection of these accounting policies and estimates with the Audit and Finance Committee of the Board. However, even under optimal circumstances, estimates routinely require adjustment based on changing circumstances and new or better information.

The three accounting policies that are considered either the most judgmental, or involve the selection or application of alternative accounting policies, and are material to the financial statements, are those related to the recording of workers' compensation costs, deferred revenue-prepaid postage and contingent liabilities. For further information, see *Item 8. Financial Statements and Supplementary Data*, *Notes to Financial Statements*, *Note 1 - Organization and Summary of Significant Accounting Policies*, *Note 12 - Workers' Compensation* and *Note 9 - Commitments and Contingencies*.

WORKERS' COMPENSATION

Workers' compensation costs reflected in our accompanying *Statements of Operations* are subject to actuarial estimates of future claim payments based upon past claim payment experience. Workers' compensation costs are highly sensitive to discount and inflation rates, which are updated on a quarterly basis and the length of time recipients are expected to stay on the compensation rolls. However, the annual cash payment for claims is relatively stable and predictable.

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

DEFERRED REVENUE-PREPAID POSTAGE

Deferred revenue-prepaid postage is an estimate of postage that has been sold, but not yet used by customers. Revenue is recognized only when mail is delivered, not when postage is purchased, and revenue is deferred and reflected in the accompanying *Balance Sheets* as *Deferred revenue-prepaid postage.* The deferred revenue estimate is developed and validated through complex mathematical and statistical methods of stamp usage trends. Small differences in inputs can lead to significant differences in the estimate of the liability. Three categories of postage sales account for the majority of *Deferred revenue-prepaid postage*: *Forever stamp* sales, metered postage and mail-in-transit, which is mail that has not reached its final destination.

During 2016, we revised the estimation technique utilized to estimate our *Deferred revenue-prepaid postage* liability for *Forever Stamps*. The change resulted from new information regarding customer's retention and usage habits of applicable postage, and enabled the Postal Service to update its estimate of stamps that will never be used for mailing. As a result of this change, *Deferred revenue-prepaid postage* was decreased by nearly $1.1 billion. In accordance with GAAP, the change was accounted for as a change in accounting estimate, and was reflected in operating results as an increase to revenue and a decrease to net loss by the same amount in the year ended September 30, 2016.

CONTINGENT LIABILITIES

The recording of contingent liabilities requires significant judgment in estimating potential losses for legal and other claims. Each quarter, significant new claims and litigation are evaluated for the probability of an adverse outcome. Liabilities are recorded in the accompanying *Balance Sheets* within *Trade payables and accrued expenses* and *Other noncurrent liabilities* when amounts are deemed both probable and estimable.

In addition, any prior claims and litigation are reviewed and, when necessary, the liability balances are adjusted for resolutions or revisions to prior estimates. Estimates of loss can therefore change as individual claims develop and additional information becomes available. We disclose the range of amounts for pending claims and litigations that are deemed to be reasonably possible of an unfavorable outcome, but do not accrue for or include such provisions in our financial statements.

RECENT ACCOUNTING STANDARDS

New accounting guidance that we have recently adopted, as well as accounting guidance that has been recently issued but not yet adopted by us, are included in *Item 8. Financial Statements and Supplementary Data*, *Notes to Financial Statements*, *Note 1 - Organization and Summary of Significant Accounting Policies*, *Summary of Significant Accounting Policies*, *Recently Adopted Accounting Pronouncements* and *Recently Issued Accounting Pronouncements*.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The market rate risks we encounter are primarily related to foreign currency exchange rate fluctuations, interest rates and commodity prices. Historically, we have not entered into derivatives contracts or commodity instruments for trading or speculative purposes or to manage market risks.

FOREIGN EXCHANGE RISK

While we operate outside of the U.S., and foreign currency fluctuations may favorably or unfavorably impact our reported earnings, we believe that foreign exchange risk is not a material amount since the vast majority of our business transactions are denominated in U.S. dollars. Because of this, we estimate that a 1% increase or decrease in foreign exchange rates would not have a material impact on our financial statements.

INTEREST RATE RISK

We are impacted by changes in interest rates in the normal course of our business operations as a result of our ongoing investing and financing activities which include our revolving credit line facilities and floating note purchase agreements as well as our cash and cash equivalents. We assess our interest rate risks on a regular basis and currently estimate that a 1% increase in interest rates would have resulted in approximately a $34 million increase in 2017 interest expense.

We currently have no significant exposure to changing interest rates on our noncurrent debt as interest rates are fixed on such debt. As disclosed in the accompanying notes to the financial statements, see *Item 8. Financial Statements and Supplementary Data*, *Notes to Financial Statements*, *Note 14 - Fair Value Measurement*, the fair value of our noncurrent debt, exclusive of capital leases, was $5.2 billion and $5.5 billion for the years ended September 30, 2017, and 2016, respectively. The underlying fair value of our noncurrent debt was estimated using prices provided by the FFB.

We also have interest rate risk associated with our workers' compensation liability, which is highly sensitive to changes in discount rates. An increase of 1% in the interest rates would decrease the liability at September 30, 2017, and 2017 expense by approximately $1.9 billion. A decrease of 1% would increase the liability at September 30, 2017, and 2017 expense by approximately $2.3 billion. See *Item 8. Financial Statements and Supplementary Data*, *Notes to Financial Statements*, *Note 12 - Workers' Compensation* for further explanation.

COMMODITY PRICES RISK

We currently have market risk for changes in fuel and natural gas costs. As of September 30, 2017, we estimated that a 1% increase in fuel and natural gas would have resulted in a $21 million increase in 2017 expense.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Temporary Emergency Committee of the Board of Governors of the United States Postal Service

We have audited the accompanying balance sheets of the United States Postal Service as of September 30, 2017 and 2016, and the related statements of operations, changes in net deficiency, and cash flows for each of the three years in the period ended September 30, 2017. These financial statements are the responsibility of the United States Postal Service's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the United States Postal Service at September 30, 2017 and 2016, and the results of its operations and its cash flows for each of the three years in the period ended September 30, 2017, in conformity with U.S. generally accepted accounting principles.

As discussed more fully in Note 2 to the financial statements, the United States Postal Service, an independent establishment of the executive branch of the Government of the United States, is dependent upon future actions of the Government to continue its operations in the ordinary course as a result of continuing operating losses and statutory funding requirements for employee benefit obligations. The Postal Service has incurred recurring losses from its operations primarily due to sustained declines in mail volume, and statutory and regulatory restrictions have constrained the ability of the Postal Service to implement strategies to improve efficiency, reduce costs and increase revenues. Due to these conditions, the Postal Service remains in default of the $33.9 billion of required prefunding payments, which were due in previous years, that was to be paid to the Postal Service Retiree Health Benefits Fund (PSRHBF) by Public Law (P.L.) 109-435, per the Postal Accountability and Enhancement Act. The Postal Service also did not make payments due by September 30, 2017, totaling $6.9 billion for the normal cost of retiree health benefits and amortization payments for PSRHBF, the Civil Service Retirement System and the Federal Employee Retirement System unfunded liabilities. The Postal Service does not expect to have sufficient cash to satisfy these obligations. The Postal Service does not, at this time, anticipate any legal consequences, under current law, from its inability to make the required payments. Management expects, but no assurances can be given, that additional legislation will be enacted to address the short-term funding requirements of the United States Postal Service and to address regulatory restrictions that have not allowed the Postal Service to adjust its operations to levels commensurate with its current revenue base.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States) and in accordance with auditing standards generally accepted in the United States of America, the United States Postal Service's internal control over financial reporting as of September 30, 2017, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) and our report dated November 14, 2017 expressed an unqualified opinion thereon.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 14, 2017 on our consideration of the United States Postal Service's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the United States Postal Service's internal control over financial reporting and compliance.

/s/ Ernst & Young LLP

Tysons, Virginia
November 14, 2017

UNITED STATES POSTAL SERVICE
STATEMENTS OF OPERATIONS

(in millions)	Year Ended September 30, 2017	2016	2015
Revenue			
Operating revenue	$ 69,593	$ 71,429	$ 68,790
Other revenue	43	69	138
Total revenue	**69,636**	**71,498**	**68,928**
Operating expenses			
Compensation and benefits	49,108	48,441	47,278
Unfunded retirement benefits	2,658	248	241
Retiree health benefits	4,260	9,105	8,811
Workers' compensation	(797)	2,682	1,760
Transportation	7,238	6,992	6,579
Other operating expenses	9,743	9,431	9,157
Total operating expenses	**72,210**	**76,899**	**73,826**
Loss from operations	**(2,574)**	**(5,401)**	**(4,898)**
Interest and investment income	58	32	23
Interest expense	(226)	(222)	(185)
Net loss	**$ (2,742)**	**$ (5,591)**	**$ (5,060)**

See accompanying notes to the financial statements.

UNITED STATES POSTAL SERVICE
BALANCE SHEETS

(in millions)	September 30, 2017	September 30, 2016
Current Assets:		
Cash and cash equivalents	$ 10,513	$ 8,077
Restricted cash	291	253
Receivables, net	1,127	1,042
Supplies, advances and prepayments	134	140
Total current assets	**12,065**	**9,512**
Property and equipment, net	14,891	15,296
Other assets	438	411
Total assets	**$ 27,394**	**$ 25,219**
Current Liabilities:		
Compensation and benefits	$ 2,397	$ 2,174
Unfunded retirement benefits	3,153	495
Retiree health benefits	38,160	33,900
Workers' compensation costs	1,513	1,427
Payables and accrued expenses	1,930	1,892
Deferred revenue-prepaid postage	2,168	2,253
Customer deposit accounts	1,196	1,246
Other current liabilities	1,210	1,128
Current portion of debt	10,100	10,100
Total current liabilities	**61,827**	**54,615**
Workers' compensation costs, noncurrent	16,397	18,612
Employees' accumulated leave, noncurrent	1,918	1,926
Other noncurrent liabilities	1,076	1,148
Noncurrent portion of debt	4,900	4,900
Total liabilities	**86,118**	**81,201**
Net Deficiency:		
Capital contributions of the U.S. government	3,132	3,132
Deficit since 1971 reorganization	(61,856)	(59,114)
Total net deficiency	**(58,724)**	**(55,982)**
Total liabilities and net deficiency	**$ 27,394**	**$ 25,219**

See accompanying notes to the financial statements.

UNITED STATES POSTAL SERVICE
STATEMENTS OF CHANGES IN NET DEFICIENCY

(in millions)	Capital Contributions of U.S. Government	Accumulated Deficit Since Reorganization	Total Net Deficiency
Balance, September 30, 2014	**$ 3,132**	**$ (48,463)**	**$ (45,331)**
Net loss	—	(5,060)	(5,060)
Balance, September 30, 2015	**$ 3,132**	**$ (53,523)**	**$ (50,391)**
Net loss	—	(5,591)	(5,591)
Balance, September 30, 2016	**$ 3,132**	**$ (59,114)**	**$ (55,982)**
Net loss	—	(2,742)	(2,742)
Balance, September 30, 2017	**$ 3,132**	**$ (61,856)**	**$ (58,724)**

See accompanying notes to the financial statements.

UNITED STATES POSTAL SERVICE
STATEMENTS OF CASH FLOWS

(in millions)	Years Ended September 30, 2017	2016	2015
Cash flows from operating activities:			
Net loss	$ (2,742)	$ (5,591)	$ (5,060)
Adjustments to reconcile net loss to cash provided by operations:			
Depreciation and amortization	1,677	1,740	1,769
Gain on disposals of property and equipment, net	(7)	(11)	(59)
(Increase) decrease in other assets	(27)	2	7
(Decrease) increase in noncurrent workers' compensation	(2,215)	1,202	308
Decrease in noncurrent deferred appropriations and other revenue	(94)	(40)	(8)
Increase (decrease) in other noncurrent liabilities	61	(122)	(215)
Changes in current assets and liabilities:			
Receivables, net	(85)	(112)	—
Other assets	6	(22)	4
Retiree health benefits	4,260	5,800	5,683
Unfunded retirement benefits	2,658	248	234
Payables, accrued expenses and other	383	687	72
Deferred revenue-prepaid postage, prepaid box rents and other	(52)	(1,045)	144
Net cash provided by operating activities	**3,823**	**2,736**	**2,879**
Cash flows from investing activities:			
Purchases of property and equipment	(1,344)	(1,428)	(1,222)
Proceeds from sales of property and equipment	58	206	120
Net cash used in investing activities	**(1,286)**	**(1,222)**	**(1,102)**
Cash flows from financing activities:			
Issuance of notes payable	29,800	7,600	5,800
Payments on notes payable	(29,800)	(7,600)	(5,800)
Changes in capital lease obligations and other	(63)	(51)	(62)
Net cash used in financing activities	**(63)**	**(51)**	**(62)**
Net increase in cash, cash equivalents and restricted cash	2,474	1,463	1,715
Cash, cash equivalents and restricted cash at beginning of year	8,330	6,867	5,152
Cash, cash equivalents and restricted cash at end of year	**$ 10,804**	**$ 8,330**	**$ 6,867**
Supplemental cash flow disclosures:			
Cash paid for interest	$ 214	$ 188	$ 179

See accompanying notes to the financial statements.

NOTES TO FINANCIAL STATEMENTS

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

The United States Postal Service (the "Postal Service") provides postage, mail delivery and shipping services to retail and commercial customers in the communications, distribution and delivery, advertising and retail markets throughout the nation and internationally. As a result, the Postal Service maintains a very diverse customer base and is not dependent upon a single customer or small group of customers. No single customer represented more than 5% of operating revenue for the years ended September 30, 2017, 2016 and 2015. The Postal Service is subject to congressional oversight and regulation by the Postal Regulatory Commission ("PRC"), but does not receive tax dollars for operating expenses, relying solely on the sale of postage, products and services to fund its operations.

The *Postal Accountability and Enhancement Act of 2006*, Public Law 109-435 ("PAEA") classifies the services offered by the Postal Service as either Market-Dominant or Competitive products; however, the term "services" is used in this report for consistency with other descriptions of services the Postal Service offers. The Postal Service provides services through approximately 31,000 Postal Service-managed Post Offices, stations and branches, plus approximately 4,000 additional Contract Postal Units, Community Post Offices, Village Post Offices, and a large network of commercial outlets which sell stamps and services on the Postal Service's behalf and through its website www.usps.com. The Postal Service delivers to approximately 157 million city, rural, *PO Box* and highway delivery points. Operations are conducted primarily in the domestic market, with international revenue representing approximately 4% of operating revenue.

Approximately 92% of career employees are covered by collective bargaining agreements and are 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"). The contracts with the four labor unions representing the majority of Postal Service employees include provisions granting annual increases and cost-of-living adjustments ("COLAs"), which are linked to the CPI-W. For further information on collective bargaining agreements, see *Note 9 - Commitments and Contingencies.*

By law, the Postal Service must consult with management organizations representing most of its employees not covered by collective bargaining agreements. These consultations provide non-bargaining unit employees in the field with an opportunity to participate in the planning, development and implementation of certain programs and policies that affect them.

Summary of Significant Accounting Policies

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

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

Cash and Cash Equivalents

Cash and Cash Equivalents consists of cash and short-term, highly-liquid investments with maturities of 90 days or less. See *Note 4 - Cash, Cash Equivalents and Restricted Cash* for additional information.

Restricted Cash

Restricted Cash represents Postal Service cash that is not available for general use. This includes cash originated from forfeitures or seizures related to consumer fraud or other criminal activity related to the mail and either held for third-party beneficiaries or awaiting disposition. *Restricted Cash* also includes funds designated for specific use due to congressional appropriation for Postal Service obligations to the PRC and the United States Postal Service Office of Inspector General, or other restriction. See *Note 4 - Cash, Cash Equivalents and Restricted Cash* for additional information.

Receivables, net
Receivables, net represents Postal Service receivables recorded at the amount invoiced, net of allowances. Allowances for potential losses are recognized at each balance sheet date. These estimates are determined based on historical collection experience, trends in customer payment frequency and judgments about the probable effects on observable data, including present economic conditions and the financial health of specific customers and market sectors. See *Note 5 - Receivables and Customers* for additional information.

Property and Equipment, net
Property and Equipment, net represents property and equipment recorded at cost, including the interest on borrowings used to pay for the construction of major capital additions, less accumulated depreciation. Depreciation expense is recorded using the straight-line method over estimated useful life, which ranges from 3 to 40 years. Depreciation expense is included within *Other operating expenses* in the accompanying *Statements of Operations*. The costs and accumulated depreciation of assets sold or retired are removed from balance sheet accounts in the period in which the transaction occurred. General maintenance and repair costs are charged to expense as incurred. See *Note 6 - Property and Equipment, net* for additional information.

Software Capitalization
Software costs, including internal development costs, are capitalized when they meet certain criteria. Costs to be capitalized include both contracted resources and employee labor costs involved in the development. Interest costs incurred while developing internal-use software are also capitalized. Costs are accumulated until the software is put into production, at which time amortization of the internal-use software begins for a period not to exceed 3 years. See *Note 6 - Property and Equipment, net* for additional information.

Leases
The Postal Service leases over 23,000 real properties. As the lessee, the Postal Service classifies a lease which has substantially all the risks and rewards of ownership as a capital lease. These leases are capitalized on the lease commencement date at the lower of the fair value of the leased assets and the present value of the minimum lease payments. The discount rate used to determine the present value is based on average U.S. Treasury rates. Property acquired under a capital lease is amortized over the lease term. Capital leases are included within *Property and equipment, net* in the accompanying *Balance Sheets*.

Other lease arrangements in which substantially all risks and rewards of ownership are retained by the lessor are classified as operating leases. Rent expense for operating leases is included in *Other operating expenses* in the accompanying *Statements of Operations* on a straight-line basis over the term of the lease.

Impaired Assets
Impairment losses on long-lived assets are recorded when events or circumstances indicate that an asset's fair value is less than its carrying value. When such a determination is made, the carrying values of the assets are written down to fair value. Fair value is determined by independent appraisals for real property. Due to the absence of a market for most types of mailing equipment, impaired equipment assets are typically assigned a fair value of zero. See *Note 6 - Property and Equipment, net* for additional information.

Employees' Accumulated Leave
Employees' accumulated leave represents leave earned as of the balance sheet date and is recorded net of advances. Career employees earn annual leave based on the number of creditable years of service with the Postal Service. The Postal Service advances annual leave to employees at the beginning of each calendar year for the value of leave they will earn for the current year. Leave taken by employees before it is earned is considered an advance. Advances were $159 million and $149 million at September 30, 2017, and 2016, respectively, and are included within *Employees' accumulated leave, noncurrent* in the accompanying *Balance Sheets*. The current portion of employees' accumulated leave, which consists of holiday leave, was $131 million and $131 million at September 30, 2017, and 2016, respectively, and is included under *Current liabilities* within *Compensation and benefits* in the accompanying *Balance Sheets*.

Retiree Benefits
Career employees are eligible to participate in the U.S. government pension and retiree health benefits programs. The Postal Service is required to provide funding for these plans as determined by the Office of Personnel Management ("OPM"), the administrator of the plans. The Postal Service cannot direct the costs, benefits or funding requirements of the plans. Accordingly, the plans are accounted for using multiemployer plan accounting rules, and expenses are recorded in the period in which the contributions are due and payable. See *Note 10 - Retirement Plans* and *Note 11 - Health Benefits Plans* for additional information.

Workers' Compensation
Postal Service employees are covered by the *Federal Employees' Compensation Act* ("FECA"), administered by the Department of Labor ("DOL") Office of Workers' Compensation Programs ("OWCP"). The Postal Service uses an estimation model to forecast and record the workers' compensation liability for the present value of estimated future payments. See *Note 12 - Workers' Compensation* for additional information.

Deferred Revenue–Prepaid Postage
Deferred revenue–prepaid postage is an estimate of postage that the Postal Service has sold but customers have not yet used. Revenue is recognized at the time mail is delivered. Because payments for postage are collected in advance of services being performed, revenue is deferred and reflected as *Deferred revenue–prepaid postage* in the accompanying *Balance Sheets*. Stamp sales and metered postage account for the majority of *Deferred revenue–prepaid postage*. Included in the estimate of the liability is an estimate for mail that is in-transit within the Postal Service network. See *Note 7 - Payables, Accrued Expenses and Deferred Revenue* for additional information.

Contingent Liabilities
The Postal Service is a party to various legal proceedings and claims in the normal conduct of its operations. Contingent liabilities require significant judgment in estimating potential losses. Each quarter, significant new claims and litigation are evaluated for the probability of an adverse outcome. Any prior claims and litigation are also reviewed, and when necessary, the liability balance is adjusted for resolutions or revisions to prior estimates. Estimates of loss can therefore change as additional information becomes available. See *Note 9 - Commitments and Contingencies* for additional information.

Revenue Forgone
Under the *Revenue Forgone Reform Act of 1993*, Congress agreed to reimburse the Postal Service $1.2 billion in 42 annual "installments" of $29 million through 2035 for certain services the Postal Service performed during years 1991 through 1998. Additionally, each year the Postal Service estimates the costs it incurs to provide "free and reduced mail" services to groups of mailers that Congress has determined should be subsidized, and the Postal Service submits these estimates annually to Congress. Congress then considers this for funding, which may be modified and approved or denied, under an appropriation for both of these components of revenue forgone. See *Note 13 - Revenue Forgone* for additional information.

Emergency Preparedness Plan
As a result of an act of biological terrorism, Congress appropriated funds to the Postal Service in 2001 and 2002 to support the costs of maintaining the safety of Postal Service employees and customers, as well as mail and packages in transit. These appropriated funds were accounted for as deferred revenue upon receipt and were generally used to procure capital equipment.

When the Postal Service recorded depreciation expense for equipment purchased with funds from the Emergency Preparedness Fund appropriation, it recognized revenue for emergency preparedness appropriations concurrently. All equipment purchased with these funds was fully depreciated as of September 30, 2015, with $86 million being recognized in *Operating revenue* that year in the accompanying *Statements of Operations*.

Advertising
Advertising costs, which the Postal Service expenses as they are incurred, were $164 million, $163 million and $160 million for the years ended September 30, 2017, 2016 and 2015, respectively, and are included within *Other operating expenses* in the accompanying *Statements of Operations*.

Foreign Currency Translation
Foreign currency translation risk can arise from international mail transactions related to settlements of receivables and payables with foreign postal administrations. The majority of international accounts are denominated in special drawing rights, based on a group of currencies comprised of the Euro, Japanese yen, British pound sterling and the U.S. dollar, which fluctuate daily. Changes in the relative value of these currencies increase or decrease the value of the settlement accounts and result in a gain or loss that is included in operating results. The impact of foreign currency translation on operating results was not material for the years ended September 30, 2017, 2016 and 2015.

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

Related Parties
As disclosed throughout this report, the Postal Service conducts significant transactions with other U.S. government entities. See *Note 3 - Related Parties* for additional information.

Reclassifications
Certain reclassifications have been made to the financial statements for the years ended September 30, 2016 and 2015, to conform to the current year presentation. Specifically, certain retirement benefits have been reclassified from *Compensation and benefits* and separately identified as *Unfunded retirement benefits* within *Operating expenses* in the accompanying *Statements of Operations.* In addition, the liabilities associated with these retirement benefits have been reclassified from *Compensation and benefits* and separately identified as *Unfunded retirement benefits* within *Current liabilities* in the accompanying *Balance Sheets*. Corresponding reclassification occurred within *Changes in current assets and liabilities* in the accompanying *Statements of Cash Flows*. These reclassifications had no effect on previously reported operating expenses, operating loss or net loss.

2016 Change in Accounting Estimate
During 2016, the Postal Service revised the estimation technique utilized to estimate its *Deferred revenue-prepaid postage* liability for a series of postage stamps. The change resulted from new information regarding customers' retention and usage habits of *Forever Stamps*, and enabled the Postal Service to update its estimate of usage and "breakage" (representing stamps that will never be used for mailing due to loss, damage or stamp collection).

As a result of this change in estimate, the *Deferred revenue-prepaid postage* was decreased by nearly $1.1 billion. In accordance with GAAP, the change was accounted for as a change in accounting estimate, and was reflected in operating results as an increase to revenue and a decrease to net loss by the same amount in the year ended September 30, 2016.

Recently Adopted Accounting Pronouncements

Accounting Standards Update 2014-15 Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern
In August 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update 2014-15 *Disclosure of Uncertainties about an Entity's Ability to Continue as a Going Concern* ("ASU 2014-15"). The new standard requires an entity to perform interim and annual assessments of its ability to continue to meet obligations as they become due within one year after the date that the financial statements are issued.

The Postal Service has adopted ASU 2014-15 as of September 30, 2017, and has completed a multi-step evaluation of its ability to meet its obligations as they become due within one year after the date that the financial statements are to be issued. Although certain risk factors about the Postal Service's ability to continue as a going concern were identified, management has determined that the Postal Service has the ability to continue as a going concern for at least the next year based on it plans for mitigation. See *Note 2 - Liquidity* for further details.

Accounting Standards Update 2016-18 Statement of Cash Flows, Restricted Cash
In November 2016, the FASB issued Accounting Standards Update 2016-18 *Statement of Cash Flows, Restricted Cash* ("ASU 2016-18"). The new standard provides final guidance, based on a consensus of the Emerging Issues Task Force, to clarify how entities should present restricted cash in the statements of cash flows. The new standard requires entities to show the change in the total of cash, cash equivalents and restricted cash and no longer present transfers between cash, cash equivalents and restricted cash in the statements of cash flows.

The Postal Service elected to early adopt this standard during the second quarter of fiscal year 2017 using a retroactive application approach, which results in some presentation reclassification of cash, cash equivalents and restricted cash within the *Statements of Cash Flows* for the years ended September 30, 2017, 2016 and 2015. See *Note 4 - Cash, Cash Equivalents and Restricted Cash* for further details.

Recently Issued Accounting Pronouncements

Accounting Standards Update 2014-09 Revenue from Contracts with Customers
In May 2014, the FASB issued Accounting Standards Update 2014-09 *Revenue from Contracts with Customers* ("ASU 2014-09"). The new standard outlines a single comprehensive model for entities to use in accounting for revenue arising from

contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. The new standard may be adopted either retrospectively or on a modified retrospective basis whereby the new standard would be applied to new and existing contracts with remaining performance obligations as of the effective date, with a cumulative catch-up adjustment recorded to beginning retained earnings or net deficiency at the effective date for existing contracts with remaining performance obligations.

The new standard becomes effective for the Postal Service's 2019 fiscal year (beginning October 1, 2018) and the quarters therein. The Postal Service is in the process of evaluating the impact of the standard. As of the date of this filing, the Postal Service has completed its identification of significant revenue streams to determine the material revenue streams for further analysis. The Postal Service has begun its initial scoping analysis based on the revenue streams identified and has begun contract analysis based on the five-step model as outlined in the authoritative literature. The Postal Service anticipates using the modified retrospective approach, but does not intend to early adopt the standard.

Accounting Standards Update 2016-02 Leases

In February 2016, the FASB issued Accounting Standards Update 2016-02 *Leases* ("ASU 2016-02"). The new standard requires an entity to record most leases on its balance sheets but continue to recognize expenses in the statements of operations in a manner similar to current accounting practices. The new standard states that a lessee will recognize a lease liability for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. Expenses related to leases determined to be operating leases will be recognized on a straight-line basis, while those determined to be capital leases will generally have higher expense in the earlier periods of the lease and both interest and amortization are presented separately in the statements of operations.

ASU 2016-02 will become effective for the Postal Service's 2020 fiscal year (beginning October 1, 2019) and the quarters therein, with early adoption permitted but not elected by the Postal Service. Entities are required to use a modified retrospective approach for leases that exist or are entered into after the beginning of the earliest comparative period in the financial statements. The Postal Service has completed its initial scoping exercise and is in the process of evaluating whether embedded leases exist in its service contracts. In addition, the Postal Service has developed a plan to abstract all of the necessary information to properly account for over 23,000 property leases under the new standard. The Postal Service continues to evaluate the full impact of adopting this standard on its financial statements and disclosures, as well as its impact of adoption on Postal Service policies, practices and systems. As of September 30, 2017, the Postal Service had $7.6 billion of future minimum operating lease commitments that are not currently recognized on its balance sheets. Therefore, the Postal Service expects that the adoption will have a material effect on its financial statements and disclosures. These changes will be effective for the Postal Service's fiscal year 2020 (beginning October 1, 2019), with a modified retrospective adoption method to the beginning of fiscal year 2018.

Accounting Standards Update 2016-04 Liabilities - Extinguishments of Liabilities

In March 2016, the FASB issued Accounting Standards Update 2016-04 *Liabilities - Extinguishments of Liabilities* ("ASU 2016-04"). The new standard requires entities that sell prepaid stored-value products redeemable for goods, services or cash at third-party merchants to recognize "breakage" (i.e., the value that is ultimately not redeemed by the consumer) in a way that is consistent with how gift card breakage will be recognized under ASU 2014-09, referenced earlier.

ASU 2016-04 will become effective for the Postal Service's 2019 fiscal year (beginning October 1, 2018) and the quarters therein, with early adoption permitted. The new standard may be adopted either retrospectively or on a modified retrospective basis with a cumulative catch-up adjustment recorded to beginning retained earnings or net deficiency as of the beginning of the fiscal year the standard is effective. The standard is applicable to the Postal Service's determination of outstanding money orders and related escheatment. The Postal Service continues to evaluate the impact of adopting this standard on its financial statements and disclosures.

NOTE 2 - LIQUIDITY

The Postal Service generates its cash almost entirely through the sale of postage and other services. It holds its cash with the Federal Reserve Bank of New York and invests its excess cash, when available, in highly-liquid, short-term investments issued by the U.S. Department of the Treasury. As of September 30, 2017, and 2016, the Postal Service held unrestricted cash and cash equivalents of $10.5 billion and $8.1 billion, respectively. The Postal Service has no remaining borrowing capacity under its statutory debt ceiling. See *Note 8 - Debt* for additional information.

Liquidity Concerns

The Postal Service is constrained by laws and regulations, including the PAEA, which restricts revenue sources and mandates certain expenses. These expenses include prefunding requirements for retiree health benefits, and amortization schedules to provide full funding of retirement and health benefits that are unlike those imposed on most other federal entities or private sector businesses. The PAEA established the Postal Service Retiree Health Benefits Fund ("PSRHBF") and mandated certain obligations for paying the normal costs and prefunding of retiree health benefits, described below and in *Note 11 - Health Benefits Plans*. Additionally, as noted above, the Postal Service has reached the maximum borrowing capacity under its statutory debt ceiling.

For the year ended September 30, 2017, the Postal Service reported operating expenses of $72.2 billion and a net loss of $2.7 billion. The Postal Service has incurred cumulative net losses of $65.1 billion from 2007 through 2017 and defaulted on $33.9 billion in PSRHBF prefunding payments for the years 2012 through 2016.

The Postal Service also did not make payments due to OPM by September 30, 2017, totaling $6.9 billion for normal cost of retiree health benefits and amortization payments for PSRHBF, the Civil Service Retirement System ("CSRS") and the Federal Employee Retirement System ("FERS") unfunded liabilities in order to preserve liquidity and to ensure that the Postal Service's ability to fulfill its primary universal service mission was not placed at undue risk.

Absent legislative and regulatory change, the Postal Service projects continuing annual net losses in the future. As a result of these losses and its liquidity concerns, the Postal Service will not have sufficient liquidity to meet all of its existing legal obligations when due, to pay down its debt and to make the critical infrastructure investments that have been deferred in recent years.

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

Business Model Challenges/Constraints

Market-Dominant services, which account for approximately 70% of the Postal Service's annual operating revenues, are currently subject to a price cap as measured by the Consumer Price Index for All Urban Consumers ("CPI-U"). However, the Postal Service's costs are not similarly constrained. A large portion of its cost structure cannot be altered expeditiously due to the Postal Service's universal service obligation. Further, the number of delivery points continues to grow by approximately one million per year, which drives up delivery costs. Many employee and retiree benefit costs are mandated by law and cannot be altered without legislative change. Under current law, the Postal Service is generally unable to increase prices sufficiently to offset increased costs, and is likewise constrained by law from reducing many of its costs.

Aside from its universal service obligation, a significant factor contributing to Postal Service losses is the ongoing decline in the volume of Market-Dominant service. Specifically, secular declines in *First-Class Mail* are largely the result of changes in consumers' and businesses' use of mail resulting from the continuing migration to electronic communication and transactional alternatives, while *Marketing Mail* volume declined in 2017 largely due mailers' increasing use of digital advertising. Also contributing to losses is the increase in the number of delivery points, which, when combined with the impact of the reduction in hard-copy mail volume, has resulted in a drop in the average number of pieces delivered per delivery point per day from approximately 5.5 pieces in 2007 to 3.6 pieces in 2017, a decline of approximately 35%.

Because the Postal Service provides its services primarily through its employees, its costs are heavily concentrated in wages and benefits for both current employees and retirees. These costs are significantly impacted by wage inflation, health benefit premium increases, and retirement and workers' compensation programs. Some of these costs have historically tended to increase at a higher rate than inflation.

Expiration of Exigent Surcharge

In December 2013, after a successful appeal by the Postal Service to the U.S. Court of Appeals for the District of Columbia Circuit (the "Court") of an earlier decision in which the PRC denied outright the Postal Service's request for exigent price relief, the PRC decided that the Postal Service could collect a 4.3% exigent surcharge on most Market-Dominant services beginning in January 2014. This original authorization by the PRC allowed the Postal Service to collect the exigent surcharge until such time as it produced $3.2 billion in incremental revenue, a figure the PRC determined was lost due to the Great Recession's suppression of mail volume.

The Postal Service again appealed the PRC's decision to the Court, arguing that the PRC attributed far too little lost mail volume to the Great Recession and that the surcharge should remain in effect for a longer period of time. In June 2015, the Court issued its decision and remanded the case back to the PRC for further review. Although the Court largely upheld the PRC's analytical framework, it vacated one key aspect of the methodology for calculating mail volume lost due to the Great Recession and suggested the PRC could reconsider another element of its methodology. On July 29, 2015, the PRC announced that it had authorized the Postal Service to collect over $1.4 billion in additional incremental revenue from the surcharge, bringing the total allowed to just over $4.6 billion.

The Postal Service reduced the prices of applicable Market-Dominant services on April 10, 2016, the date the limit on the amount of exigent surcharge collected was reached.

Retiree Health and Unfunded Retirement Benefits

The Postal Service's funding requirements for retiree health benefits changed in 2017. In accordance with PAEA, the PSRHBF began paying the Postal Service's share of retiree health benefit premiums in 2017, and OPM began calculating the amount of annual payments the Postal Service must make to amortize the PSRHBF unfunded obligation. Furthermore, beginning in 2017, the Postal Service is obligated to pay into the PSRHBF the estimated normal costs of retiree health benefits attributable to the service of its employees during the most recently ended fiscal year, as calculated by OPM.

The Postal Service remains obligated to fund the $33.9 billion in PSRHBF prefunding payments that it defaulted on for the years 2012 through 2016. Given that OPM considers the $33.9 billion to be due and payable, the Postal Service continues to reflect this amount as a current liability within *Retiree health benefits* in the accompanying *Balance Sheets*.

In July 2017, OPM invoiced the Postal Service for the PSRHBF amortization payment of $955 million and the normal cost payment of $3.3 billion, each payable by September 30, 2017. As referenced above, the Postal Service recorded these as expenses but did not make either of these payments in order to preserve liquidity. This amount is also included as a current liability within *Retiree health benefits* in the accompanying *Balance Sheets.*

The Postal Service's obligations pertaining to CSRS changed in 2017 according to PAEA, and the Postal Service is now obligated to make annual payments to OPM to fully amortize its CSRS unfunded liabilities. In June 2017, OPM invoiced the Postal Service $1.7 billion for the first annual CSRS amortization payment due September 30, 2017. In September 2017, OPM invoiced the Postal Service $917 million for its FERS amortization obligation, also due September 30, 2017. As referenced above, the Postal Service recorded these as expenses but did not make either of these payments to OPM in order to preserve liquidity.

The following table shows a composition of the expenses related to retiree health benefits, CSRS and FERS for the years ended September 30, 2017, 2016 and 2015:

(in millions)	**2017**	**2016**	**2015**
PSRHBF unfunded liability expense[1]	$ 955	$ —	$ —
PSRHBF prefunding fixed amount[2]	—	5,800	5,700
Normal cost of retiree health benefits[3]	3,305	—	—
Retiree health benefits premiums[4]	—	3,305	$ 3,111
CSRS unfunded benefits expense[5]	1,741	—	—
FERS unfunded benefits expense[6]	917	248	241

[1] Expense for the annual payment due by September 30, 2017, on the unfunded liability as calculated by OPM.

[2] Expense for the annual prefunding payments to the PSRHBF due on September 30, 2016, and 2015, upon which the Postal Service defaulted.

[3] Expense for the annual payment due to the PSRHBF by September 30, 2017, as calculated by OPM, for the actuarially-determined normal cost of retiree health benefits for current employees.

[4] Expense for the amount the Postal Service incurred for its share of retiree health benefit premiums. Beginning in 2017, the PSRHBF pays the Postal Service's share of retiree health benefit premiums.

[5] Expense for the annual payment due September 30, 2017, calculated by OPM, to amortize the unfunded CSRS retirement obligation as of September 30, 2016, the date of the most recent available information. Payments are to be made in equal installments through 2043.

[6] Expense for the annual payment due September 30, 2017, calculated by OPM, to amortize the unfunded FERS retirement obligation as of September 30, 2016, the date of the most recent available information. Payments are to be made in equal installments through 2046.

The Postal Service determined that given its ongoing liquidity concerns, and without legislative and regulatory action, it could not make all legally-required payments in 2017 and still have sufficient cash to ensure that it can fulfill its statutory universal service obligation. Additionally, the Postal Service believes that continuing productivity improvements alone will not be sufficient to address the challenges presented by declining Market-Dominant volume and revenue, and that it is unlikely that revenue growth will keep pace with increased costs.

Mitigating Circumstances

The Postal Service continues to pursue strategies within its control to increase operational efficiency and improve liquidity. The Postal Service has conserved capital in recent years by spending only what it believed essential to maintain its existing facilities and service levels. However, an increase in capital investment is necessary to upgrade its facilities, its existing fleet of vehicles, and its processing equipment in order to remain operationally viable.

The Postal Service continues to support legislation that will enable it to increase revenue and reduce costs. Specifically, reforms to establish a set of health care plans fully integrated with Medicare for current and future Postal Service retirees, would largely eliminate the current unfunded liability and substantially reduce annual amortization and normal cost payment requirements.

The Postal Service's status as an independent establishment of the executive branch that does not receive tax dollars for its operations presents unique requirements and restrictions, but also potentially mitigates some of the financial risk that would otherwise be associated with a cash shortfall. With annual revenue of approximately $70 billion, a financially-sound Postal Service continues to be vital to U.S. commerce.

The U.S. economy benefits greatly from the Postal Service and the many businesses that provide the printing and mailing services that it supports. Disruption of the mail would cause undue hardship to businesses and consumers, and in the event of a cash shortfall, the U.S. government would likely prevent the Postal Service from significantly curtailing or ceasing operations. The Postal Service continues to inform the Administration, Congress, the PRC and other stakeholders of the immediate and long-term financial challenges it faces and the legislative changes that are required to restore its financial stability.

NOTE 3 - RELATED PARTIES

The Postal Service conducts significant transactions with other U.S. government entities, which are considered related parties.

The following table presents related-party assets and liabilities as of September 30, 2017, and 2016:

(in millions)		September 30, 2017		September 30, 2016
Related-party assets:				
Receivables and advances[1]	$	47	$	40
Carrying amount of revenue forgone installment receivable[2]		426		405
Related-party liabilities:				
Current portion of debt	$	10,100	$	10,100
Other current liabilities[3]		43,504		36,509
Noncurrent portion of debt		4,900		4,900
Other noncurrent liabilities[4]		16,420		18,638

[1] Current portion within *Receivables, net* and noncurrent portion within *Other assets* in the accompanying *Balance Sheets*.
[2] Included within *Other assets* in the accompanying *Balance Sheets*.
[3] Amounts include CSRS, FERS and PSRHBF obligations and current workers' compensation obligations.
[4] Amounts include noncurrent workers' compensation obligations.

The following table presents related-party revenue and expenses for the years ended September 30, 2017, 2016 and 2015:

(in millions)	2017	2016	2015
Related-party operating revenue[1]	$ 975	$ 1,054	$ 999
Related-party operating expenses[2]	16,544	18,830	18,136
Related-party interest income[3]	58	31	23
Related-party interest expenses[4]	205	195	182

[1] Included within *Operating revenue* in the accompanying *Statements of Operations*.

[2] Included within *Operating expenses* in the accompanying *Statements of Operations*.

[3] Imputed on the revenue forgone installment receivable or generated on cash equivalents held with the Federal Reserve Bank of New York or short-term investments in U.S. Treasury instruments. Included within *Interest and investment income* in the accompanying *Statements of Operations*.

[4] Incurred on debt issued to the Federal Financing Bank, and included within *Interest expense* in the accompanying *Statements of Operations*.

NOTE 4 - CASH, CASH EQUIVALENTS AND RESTRICTED CASH

The Postal Service elected to early adopt ASU 2016-18 as of March 31, 2017. Adoption of this standard is considered a change in accounting principle using a retrospective application approach, which results in some reclassification, for presentation purposes, of cash, cash equivalents and restricted cash in the accompanying *Statements of Cash Flows* for the years ended September 30, 2017, 2016 and 2015.

The following table provides a reconciliation of cash, cash equivalents and restricted cash reported in the accompanying *Balance Sheets* as of September 30, 2017, and 2016, respectively, along with the reported cash, cash equivalents and restricted cash balances as of September 30, 2015, that sum to the totals of the same such amounts reported in the accompanying *Statements of Cash Flows* for the years ended September 30, 2017, 2016 and 2015:

	September 30,		
(in millions)	2017	2016	2015*
Cash and cash equivalents	$ 10,513	$ 8,077	$ 6,634
Restricted cash	291	253	233
Total cash, cash equivalents and restricted cash as reported in the accompanying *Statements of Cash Flows*	**$ 10,804**	**$ 8,330**	**$ 6,867**

* The 2015 opening balances for cash and cash equivalents, restricted cash, and total cash, cash equivalents and restricted cash as reported in the accompanying *Statements of Cash Flows* were $4.9 billion, $246 million and $5.2 billion, respectively.

NOTE 5 - RECEIVABLES AND CUSTOMERS

The Postal Service's operations are conducted primarily in the domestic market, with international revenue representing 3.9%, 3.8% and 3.9% of operating revenue for the years ended September 30, 2017, 2016 and 2015, respectively. For the years ended September 30, 2017, 2016 and 2015, combined revenue from the Postal Service's three largest customers (excluding mail service providers) represented approximately 7.6%, 5.8% and 5.1% of operating revenue, respectively.

The following table details *Receivables, net* from the accompanying *Balance Sheets* as of September 30, 2017, and 2016:

(in millions)		2017		2016
Foreign countries	$	800	$	776
U.S. government*		39		34
Other		342		302
Receivables before allowances		1,181		1,112
Less: Allowances		54		70
Receivables, net	**$**	**1,127**	**$**	**1,042**

* U.S. government receivables amounts exclude noncurrent receivables.

Receivables from foreign countries were 67.7% and 69.8% of the total receivables before allowances as of September 30, 2017 and 2016, respectively. The largest receivable was from China, which represented 39.6% and 36.2% of the total foreign balance outstanding in 2017 and 2016, respectively. U.S. government receivables consist primarily of appropriations receivables of $19 million and $9 million, and military and official mail receivables of $17 million and $24 million as of September 30, 2017, and 2016, respectively.

Total provisions for allowances charged to expense for the years ended September 30, 2017, 2016 and 2015 were $10 million, $22 million and $10 million, respectively, and are included within *Other operating expenses* in the accompanying *Statements of Operations.*

NOTE 6 - PROPERTY AND EQUIPMENT, NET

Assets within *Property and equipment, net* are recorded at cost, which includes the interest on borrowings used to finance the construction of major capital additions, less allowances for depreciation and amortization. Interest capitalized during the years ended September 30, 2017, and 2016, was not significant. Assets within *Property and equipment, net* are depreciated over estimated useful lives that range from 3 to 40 years using the straight-line method.

The following table provides details for *Property and equipment, net* from the accompanying *Balance Sheets* as of September 30, 2017, and 2016:

(in millions, except years)	Estimated life in years		2017		2016
Buildings	3 - 40	$	25,027	$	24,704
Equipment	3 - 20		15,761		15,626
Vehicles	5 - 24		4,268		4,098
Land	-		2,820		2,840
Leasehold improvements	3 - 20		1,542		1,443
Property and equipment, at cost		**$**	**49,418**	**$**	**48,711**
Less: Accumulated depreciation and amortization			35,157		34,210
Construction in progress			630		795
Property and equipment, net		**$**	**14,891**	**$**	**15,296**

Gains recognized on assets sold are reported in *Other revenue* within the accompanying *Statements of Operations*. For the years ended September 30, 2017, 2016 and 2015, total gains, including the amortization of deferred gains noted below, were approximately $25 million, $58 million and $124 million, respectively.

The Postal Service defers gains when it enters into any lease-back arrangements or contractual obligations requiring continued Postal Service involvement with the property. Total deferred gains on the sale of property were $318 million and $404 million as of September 30, 2017, and 2016, respectively. The current portions of deferred gains were $16 million and $11 million as of September 30, 2017, and 2016, respectively, and are included within *Other current liabilities* in the accompanying *Balance Sheets*. The noncurrent portions of deferred gains were $302 million and $393 million as of September 30, 2017, and 2016, respectively, and are included within *Other noncurrent liabilities* in the accompanying *Balance Sheets*.

Deferred gains are amortized over the periods during which the Postal Service has continuing involvement with the applicable properties. The amounts amortized, included within *Other revenue* in the accompanying *Statements of Operations*, were $9 million, $9 million and $49 million for the years ended September 30, 2017, 2016 and 2015, respectively.

Impairment charges were $6 million, $17 million and $19 million for the years ended September 30, 2017, 2016 and 2015, respectively, and are included in *Other operating expenses* in the accompanying *Statements of Operations*.

Depreciation and amortization expenses were approximately $1.7 billion, $1.7 billion and $1.8 billion for the years ended September 30, 2017, 2016 and 2015, respectively, and are included within *Other operating expenses* in the accompanying *Statements of Operations*.

Capitalized software assets totaled $119 million and $98 million as of September 30, 2017, and 2016, respectively. Amortized costs were $60 million and $6 million as of September 30, 2017, and 2016, respectively. The Postal Service did not amortize any costs associated with capitalized software during 2015, as no capitalized software was put into production during that year.

The book values of assets classified as held for sale were approximately $18 million and $43 million as of September 30, 2017, and 2016, respectively, and are included within both *Land* and *Buildings* in the table above.

NOTE 7 - PAYABLES, ACCRUED EXPENSES AND DEFERRED REVENUE

Payables and Accrued Expenses

The following table provides details for *Payables and accrued expenses* from the accompanying *Balance Sheets* as of September 30, 2017, and 2016:

(in millions)	**2017**	**2016**
Trade payables	$ 694	$ 707
Foreign countries	471	453
U.S. government	87	96
Other accrued expenses	678	636
Total payables and accrued expenses	**$ 1,930**	**$ 1,892**

Deferred Revenue–Prepaid Postage

Deferred revenue for postage sales is developed and validated through complex mathematical and statistical sampling methods for estimating postage stamp usage. The estimated postage stamp usage is subtracted from stamp sales with the difference representing the Postal Service's obligation to perform future services. That obligation is reduced by recognizing a provision for postage sold that may never be used, either through loss, damage or stamp-collecting activity.

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

During 2016, the Postal Service revised the estimation technique utilized to estimate its *Deferred revenue-prepaid postage* liability for *Forever Stamps*. The change resulted from new information regarding customer's retention and usage habits of applicable postage, and enabled the Postal Service to update its estimate of stamps that will never be used for mailing. As a result of this change, *Deferred revenue-prepaid postage* was decreased by nearly $1.1 billion. In accordance with GAAP, the change was accounted for as a change in accounting estimate, and was reflected in operating results as an increase to revenue and a decrease to net loss by the same amount in the year ended September 30, 2016.

Included in the estimate of *Deferred revenue–prepaid postage* is an estimate for mail that is in-transit within the Postal Service processing and delivery network. The following table provides details for *Deferred revenue–prepaid postage* from the accompanying *Balance Sheets* as of September 30, 2017, and 2016:

(in millions)	2017	2016
Forever stamps	$ 1,220	$ 1,253
Mail in-transit	499	506
Meters	325	380
Other	124	114
Total deferred revenue-prepaid postage	**$ 2,168**	**$ 2,253**

NOTE 8 - DEBT

Under the *Postal Reorganization Act*, as amended by Public Laws 101-227 and 109-435, the Postal Service can issue debt obligations. The Postal Service is limited by statute to net annual debt increases of $3.0 billion, and total debt may not exceed $15.0 billion. Postal Service debt is issued to the Federal Financing Bank ("FFB"), a government-owned corporation under the general supervision of the Secretary of the Treasury.

Under the provisions of an annually renewable note purchase agreement with the FFB, the Postal Service can issue a series of notes with varying provisions with two days prior notice. In addition, the Postal Service can make borrowings against two revolving credit line facilities. The note purchase agreement was extended to September 30, 2018, and the revolving credit facilities have been extended until April 2018.

The first credit facility, a short-term credit line, enables the Postal Service to draw up to $3.4 billion with two days prior notice. Borrowings under this credit line are typically on an overnight basis, but can have a maximum term of up to one year. The second credit facility allows for borrowings on an overnight basis and up to $600 million on the same business day that funds are requested. The interest rates for borrowings under these credit facilities are determined by the U.S. Treasury each business day. As of September 30, 2017, these two revolving credit facilities were fully drawn.

These credit line facilities and note arrangements provide the flexibility to borrow short or long-term, using floating or fixed-rate instruments. Fixed-rate notes can be either callable or non-callable at the option of the Postal Service. All of the Postal Service's debt is unsecured, not subject to sinking fund requirements and can be repaid at any time at a price determined by the Secretary of the Treasury based on prevailing interest rates in the U.S. Treasury securities market at the time of repayment. As of September 30, 2017, the premium associated with a prepayment of all debt was $314 million based on prevailing interest rates. The weighted average interest rate for all outstanding debt was 1.785% as of September 30, 2017.

The following table provides details for *Current portion of debt* and *Noncurrent portion of debt* from the accompanying *Balance Sheets* as of September 30, 2017, and 2016:

(in millions, except percentages)	2017		2016	
Maturity	**Balance**	**Rate %**	**Balance**	**Rate %**
Current portion of debt:				
Fixed rate notes:				
October 13, 2016	$ —		$ 700	0.425
November 10, 2016	—		1,300	0.603
December 8, 2016	—		700	0.773
January 5, 2017	—		300	0.588
January 26, 2017	—		500	0.547
March 2, 2017	—		500	0.757
April 27, 2017	—		700	0.737
May 25, 2017	—		300	0.782
June 22, 2017	—		600	0.593
August 17, 2017	—		500	0.732
October 26, 2017	4,400	1.104	—	
November 9, 2017	1,000	0.895	—	
December 7, 2017	700	0.994	—	
Current revolving credit line:				
October 2, 2017	3,400	1.109	3,400	0.267
Overnight revolving credit line:				
October 2, 2017	600	1.079	600	0.318
Total current portion of debt	**10,100**		**10,100**	
Noncurrent portion of debt - fixed rate notes:				
November 15, 2018	500	3.048	500	3.048
February 15, 2019	700	3.296	700	3.296
May 15, 2019	1,000	3.704	1,000	3.704
May 15, 2019	500	3.513	500	3.513
August 16, 2021	1,000	2.066	1,000	2.066
May 17, 2038	200	3.770	200	3.770
February 15, 2039	1,000	3.790	1,000	3.790
Total noncurrent portion of debt	**4,900**		**4,900**	
Total debt	**$ 15,000**		**$ 15,000**	

At September 30, 2017, scheduled repayments of debt principal are listed below:

(in millions)		Principal Amount
2018	$	10,100
2019		2,700
2020		—
2021		1,000
2022		—
Thereafter		1,200
Total debt maturities	**$**	**15,000**

NOTE 9 - COMMITMENTS AND CONTINGENCIES

Leases

The Postal Service leases premises and equipment under operating and capital leases generally having terms from 1 to 20 years with options to renew. Certain non-cancellable real estate leases have purchase options at prices specified in the leases. The following table provides details for total rental expense for the years ended September 30, 2017, 2016 and 2015:

(in millions)		2017		2016		2015
Non-cancellable real estate leases[1]	$	940	$	908	$	915
GSA facilities leases[2]		32		31		33
Equipment and other short-term rentals		157		155		155
Total rental expense	**$**	**1,129**	**$**	**1,094**	**$**	**1,103**

[1] Sublease income was not material to the financial statements for the years ended September 30, 2017, 2016 and 2015.

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

Future minimum payments for all non-cancellable leases with original lease terms greater than one year are set forth below:

(in millions)		Operating		Capital
2018	$	829	$	70
2019		800		56
2020		751		41
2021		700		28
2022		647		14
Thereafter		3,889		52
Total lease obligations	**$**	**7,616**	**$**	**261**
Less: Interest				55
Total capital lease obligations			**$**	**206**
Less: Current portion of capital lease obligations				55
Noncurrent portion of capital lease obligations			**$**	**151**

Capital leases, recorded at historical cost within *Property and equipment, net* in the accompanying *Balance Sheets*, were $689 million and $766 million as of September 30, 2017, and 2016, respectively. Total accumulated amortization related to capital leases was $536 million and $587 million at September 30, 2017, and 2016, respectively. Amortization expense for capital leases was approximately $39 million, $42 million and $44 million for the years ended September 30, 2017, 2016 and 2015, respectively and are included within *Other operating expense* in the accompanying *Statements of Operations*.

Capital Commitments

Capital commitments consist primarily of commitments to invest in equipment and building construction and improvements. The following table provides details for approved capital projects in progress at September 30, 2017, and 2016:

(in millions)	2017	2016
Mail processing equipment	$ 370	$ 264
Building improvements, construction and building purchase	393	396
Postal support equipment	95	120
Vehicles and other	314	359
Total capital commitments	**$ 1,172**	**$ 1,139**

Contingent Liabilities

The Postal Service's contingent liabilities consist primarily of claims resulting from labor, employment, environmental matters, property damage and injuries on Postal Service properties, and issues arising from Postal Service contracts, personal claims and traffic accidents. Each quarter, the Postal Service evaluates each new claim to determine if it is probable of an unfavorable outcome and if the amount of the potential resolution is reasonably estimable. If so, a liability for the amount is recorded. Preexisting claims are also reviewed and adjusted quarterly for resolutions or revisions to prior estimates.

Provision for Losses

The Postal Service has made adequate provision for probable losses arising from all claims. The following table presents contingent liabilities by current and noncurrent portions and by category, as of September 30, 2017, and 2016:

(in millions)	2017	2016
Current/noncurrent portions of contingent liabilities:		
Current portion[1]	$ 161	$ 166
Noncurrent portion[2]	500	498
Total contingent liabilities	**$ 661**	**$ 664**
Contingent liabilities by category:		
Labor and employment matters	$ 549	$ 565
Asset retirement obligations	54	47
Tort matters	54	48
Contractual matters	4	4
Total contingent liabilities	**$ 661**	**$ 664**

[1] Included within *Payables and accrued expenses* in the accompanying *Balance Sheets*.
[2] Included within *Other noncurrent liabilities* in the accompanying *Balance Sheets*.

In addition to the amounts accrued in the financial statements, the Postal Service is subject to other claims and lawsuits which it deems reasonably possible of an unfavorable outcome, which ranged from $200 million to $675 million and from $225 million to $950 million at September 30, 2017, and 2016, respectively. The Postal Service has not recorded accruals for these reasonably possible losses in its financial statements. The Postal Service is from time to time involved in other litigation incidental to the conduct of its business, none of which is expected to be material to its business, financial condition or operations.

Class Action Litigation

As previously reported, on January 14, 2010, the Equal Employment Opportunity Commission's Office of Federal Operations certified the case *McConnell v. Brennan* (first instituted in 2006 as *McConnell v. Potter*) as a class action against the Postal Service, with the class consisting of all permanent-rehabilitation and limited-duty Postal Service employees who were assessed under the Postal Service's National Reassessment Process ("NRP") between the dates of May 5, 2006, and July 1, 2011. The

NRP was a program the Postal Service utilized to ensure that its records regarding employees injured on the job were correct and that employees receiving workers' compensation benefits were placed in jobs consistent with their abilities.

The case alleges violations of the *Rehabilitation Act of 1973* resulting from the NRP's failure to provide a reasonable accommodation, the NRP's wrongful disclosure of medical information, the creation by the NRP of a hostile work environment, and the NRP's adverse impact on disabled employees. The class is seeking injunctive relief and damages of an uncertain amount. If the plaintiffs are able to prove their allegations in this matter and to establish the damages they assert, an adverse ruling could have a material impact on the Postal Service. The Postal Service continues to dispute the claims asserted in the case and is vigorously contesting the matter.

Collective Bargaining Agreements

In April 2016, the Postal Service reached a new three-year collective bargaining agreement with the NRLCA which was ratified by NRLCA membership. The new contract includes general wage increases totaling 3.8% over three years (1.2% of which was retroactive to November 2015) with a COLA base month of July 2014 (no retroactive COLA payments), a reduction in the employer share of health insurance premiums, beginning in the 2017 plan year, and the creation of a new non-career employee category to provide weekend and holiday parcel deliveries. The contract will expire on May 20, 2018.

In July 2016, an interest arbitration decision was issued and an arbitrated contract was awarded that established a collective bargaining agreement between the Postal Service and the APWU. The contract, which will expire on September 20, 2018, was the result of a legally-mandated binding arbitration process that was required when the parties reached impasse in negotiating a new collective bargaining agreement after the prior agreement expired in May 2015. The new contract includes general wage increases totaling 3.8% over three years (1.2% of which was retroactive to November 2015) with a COLA base month of July 2014 (no retroactive COLA payments), a reduction in the employer share of health insurance premiums, beginning in the 2017 plan year, and annual increases in uniform and work clothing allowances. The award also converted approximately 5,000 non-career positions to career positions.

In December 2016, the Postal Service reached a tentative agreement with the NPMHU on a new 40-month labor contract (retroactive to May 2016) which was subsequently ratified by the union membership in February 2017. The new contract includes general wage increases totaling 3.8% over the life of the contract (1.2% of which was retroactive to November 2016) with a COLA base month of July 2014 (the first COLA payment was retroactive to September 2016), a reduction in the employer share of health insurance premiums beginning in the 2018 plan year, and annual increases in uniform and work clothing allowances. The contract will expire on September 20, 2019.

In May 2017, the Postal Service reached a tentative agreement with the NALC on a new 40-month labor contract (retroactive to May 2016) which was subsequently ratified by the union membership in August 2017. The new contract includes general wage increases totaling 2.5% over the life of the contract (1.2% of which was retroactive to November 2016) with a COLA base month of July 2014 (the first COLA payment was retroactive to September 2016), a November 2018 consolidation of the current two pay grades into a single pay grade, a reduction in the employer share of health insurance premiums beginning in the 2018 plan year, and annual increases in uniform and work clothing allowances. The contract will expire on September 20, 2019.

NOTE 10 - RETIREMENT PLANS

The majority of career employees participate in one of two U.S. government pension programs, CSRS and FERS, which are administered by OPM. These plans provide retirement, death and termination benefits for eligible employees based on specific eligibility and participation requirements, vesting periods and benefit formulas. Each employee's participation in either plan is based on the starting date of employment with the Postal Service or another U.S. government entity.

As government-sponsored benefit plans, CSRS and FERS are not subject to the provisions of the *Employee Retirement Income Security Act of 1974*, as amended. Likewise, because the Postal Service cannot direct the costs, benefits or funding requirements of these plans, it accounts for program expenses under multiemployer plan accounting rules. As such, the Postal Service records contributions to the plans as an expense in the period in which each contribution is due. Additionally, most employees may also participate in the Thrift Savings Plan ("TSP"), a defined contribution savings and investment plan administered by the Federal Retirement Thrift Investment Board.

CSRS provides a basic annuity plan benefit to employees hired before January 1, 1984. Dual CSRS provides Social Security benefits in addition to its basic annuity plan for employees hired between January 1, 1984 and January 1, 1987. CSRS and

Dual CSRS employees may also participate in the Thrift Savings Plan ("TSP"), although participants do not receive matching contributions from the Postal Service.

Effective January 1, 1987, FERS covers employees hired since December 31, 1983, and FERS employees are covered by an annuity, Social Security and TSP benefits.

The following table provides details for the number of active employees enrolled in CSRS and FERS for the years ended September 30, 2017, 2016 and 2015:

	2017	2016	2015
CSRS and Dual CSRS	27,830	33,224	39,791
FERS	474,582	474,326	452,051
Total enrollment	**502,412**	**507,550**	**491,842**

PAEA suspended the Postal Service's employer contributions to CSRS that would otherwise have been required under Title *5, Section 8334(a)(1)* of the U.S. Code, although CSRS employees continue to contribute to the plan. By law, the Postal Service does not incur normal costs for CSRS retirement benefits; however, in 2017 the Postal Service was required to begin making annual payments to amortize the unfunded CSRS liability. Employee contributions for the past three years, as a percentage of employee basic pay, were 7.0% for CSRS and either 0.8%, 3.1% or 4.4% for FERS for those employees hired before, during, or after 2013, respectively.

For most current FERS employees, the Postal Service's contribution rates of participating employees' base salaries were 13.7%, 13.7% and 13.2% for the years ended September 30, 2017, 2016 and 2015, respectively. For FERS employees who participate in TSP, the Postal Service contributes 1% of basic pay and matches voluntary employee contributions up to an additional 4% of basic pay.

FERS Employees' Current Year Service

The Postal Service records expenses for FERS employees' current year service consisting of FERS normal cost, Social Security and TSP contributions.

The Postal Service's employer cash contributions to the FERS plan for normal costs were $3.5 billion, $3.4 billion and $3.3 billion in 2017, 2016 and 2015, respectively. These cash contributions, which are included within *Compensation and benefits* in the accompanying *Statements of Operations*, exclude both employee Social Security contributions and year-end unpaid employer amounts due.

The Postal Service's Social Security contributions related to FERS employees were $2.0 billion in each of 2017, 2016 and 2015, respectively. These amounts are included in *Compensation and benefits* in the accompanying *Statements of Operations.*

The Postal Service's employer cash contributions to the TSP were $1.1 billion, $1.1 billion and $1.0 billion in 2017, 2016 and 2015, respectively. These amounts are included in *Compensation and benefits* in the accompanying *Statements of Operations.*

CSRS and FERS Unfunded Retirement Benefits

OPM periodically notifies the Postal Service regarding its revaluation of unfunded CSRS and FERS liabilities. OPM calculates these obligations using government-wide salary growth and demographic data, rather than Postal Service-specific demographics and salary growth assumptions. The Postal Service records these expenses as *Unfunded retirement benefits* in the accompanying *Statement of Operations*. These amounts may be significantly impacted by changes in actuarial assumptions used to revalue the unfunded liabilities.

The Postal Service received an invoice from OPM in the amount of $1.7 billion for the first annual CSRS amortization payment due September 30, 2017. The Postal Service received an invoice from OPM in the amount of $917 million, for its 2017 FERS obligation. As indicated elsewhere in this report, the Postal Service did not make either of these payments in order to preserve liquidity. These amounts are recorded as *Unfunded retirement benefits* in the accompanying *Statements of Operations*.

The following table presents the cost of CSRS and FERS unfunded retirement benefits for the years ended September 30, 2017, 2016 and 2015:

(in millions)	2017	2016	2015
CSRS unfunded retirement benefits	$ 1,741	$ —	$ —
FERS unfunded retirement benefits	917	248	241
Total cost of CSRS and FERS unfunded retirement benefits	**$ 2,658**	**$ 248**	**$ 241**

The amounts the Postal Service has accrued for CSRS and FERS unfunded retirement benefits but has not yet paid, including approximately $7 million from the year ended September 30, 2014, are recorded as a liability within *Unfunded retirement benefits* in the accompanying *Balance Sheets*.

For the year ended September 30, 2015, the most current period available, the Postal Service provided more than 5% of the total plan contributions for FERS from all U.S. government employers (as disclosed in OPM's *Civil Service Retirement and Disability Fund Annual Report* dated February 2017).

As noted above, the latest available actual data for the government-wide CSRS and FERS plans is September 30, 2015. As of that date, the CSRS plan for the U.S. government, taken as a whole, was approximately 30% funded. Total plan assets and accumulated benefit obligations for the CSRS plan were approximately $317 billion and approximately $1.1 trillion, respectively. The FERS plan for the U.S. government, taken as a whole, was approximately 92% funded. Total plan assets and accumulated benefit obligations for the FERS plan were approximately $557 billion and approximately $607 billion, respectively.

Total expense related to multiemployer retirement plans (which includes FERS normal cost expense, CSRS unfunded retirement benefits, and FERS unfunded retirement benefits) totaled $6.1 billion, $3.7 billion and $3.5 billion for the years ended September 30, 2017, 2016 and 2015, respectively.

NOTE 11 - HEALTH BENEFITS PLANS

The Federal Employees Health Benefits ("FEHB") Program covers nearly all career employees and also covers non-career employees and retirees who meet certain eligibility requirements. OPM administers FEHB and allocates the cost of funding the program to participating U.S. government employers. The Postal Service cannot direct the costs, benefits or funding requirements of the plans. Therefore, it accounts for program expenses using multiemployer plan accounting rules by recording contributions to the plans that will be required by OPM as an expense in the period in which the contributions are due. Although OPM determines the actual health benefits premium costs, the allocation of these costs between the Postal Service and most of its employees is determined through agreements with Postal Service labor unions.

In 2014, the Postal Service began to offer its own separate healthcare plan to certain non-career employees who are ineligible for FEHB. For the years ended September 30, 2017, 2016 and 2015, the Postal Service incurred expenses of $88 million, $33 million and $18 million, respectively, for this plan. These amounts are included within *Compensation and benefits* under *Operating Expenses* in the accompanying *Statements of Operations*.

Active Employees

The Postal Service paid approximately 74%, 74% and 75% of FEHB premium costs for active employees during the years ended September 30, 2017, 2016 and 2015, respectively. The Postal Service's employer share of employee healthcare expenses (including Medicare) was $5.2 billion, $5.0 billion, and $4.8 billion for the years ended September 30, 2017, 2016 and 2015, respectively, and these amounts are included within *Compensation and benefits* under *Operating Expenses* in the accompanying *Statements of Operations*.

Retirees

Postal Service retirees who participated in FEHB for the five years immediately preceding their retirement may continue to participate in the plan during retirement. Qualifying survivors of retirees are also eligible to receive benefits. The Postal Service pays its employer portion of FEHB insurance premiums for participating retirees and their qualifying survivors, based on each retiree's length of federal civilian service occurring on or after July 1, 1971, based on each retiree's length of federal civilian service occurring after that date. Each participant's share of premium costs is set by law and is not subject to negotiation with Postal Service labor unions. The Postal Service expenses what it is billed by OPM.

The PAEA required the Postal Service to prefund retiree health benefits during years 2007 through 2016 by paying annual amounts ranging from $1.4 billion to $5.8 billion, totaling $54.8 billion, into the PSRHBF, which began paying the Postal Service's share of retiree health benefit premiums in 2017. Most federal entities and private sector businesses are not subject to this type of prefunding requirement. Because the amounts required to be paid into the PSRHBF are set by PAEA, retiree health benefits expenses during the years 2007 through 2016 may represent more or less than the full cost of the benefits earned by Postal Service employees during those specific years.

The Postal Service defaulted on $33.9 billion of the PSRHBF prefunding payments for the years 2012 through 2016. Prior to each default, the Postal Service notified key stakeholders including the Administration and Congress prior to the defaults. PAEA contains no provisions addressing a payment default, and as of the date of this report, the Postal Service has not been assessed any penalties.

The cumulative amounts of defaulted PSRHBF prefunding and normal cost payments were $38.2 billion and $33.9 billion as of September 30, 2017, and 2016, respectively, and are recorded as *Retiree health benefits* under *Current Liabilities* in the accompanying *Balance Sheets*. Given that OPM considers these amounts to be due and payable, the Postal Service continues to reflect these amounts as a current liability within *Retiree health benefits* in the accompanying Balance Sheets.

As required by PAEA, OPM performed an actuarial valuation for the purpose of developing a payment schedule to fund the remaining unfunded PSRHBF obligation over a period of 40 years through 2056. The Postal Service received an invoice from OPM for an amortization payment for 2017 of $955 million, which was due by September 30, 2017. As indicated above, the Postal Service recorded an expense for this amount but did not make this payment in order to preserve liquidity.

Furthermore, beginning in 2017, the Postal Service is obligated to pay the estimated normal costs of retiree health benefits attributable to the service of its employees during the most recently ended fiscal year. OPM's invoice for the normal cost payment, also due by September 30, 2017, was $3.3 billion. As indicated above, the Postal Service also recorded an expense for this amount but did not make this payment in order to preserve liquidity.

The following table details retiree health benefits expense for the years ended September 30, 2017, 2016 and 2015:

(in millions)		2017		2016		2015
PSRHBF unfunded liability expense[1]	$	955	$	—	$	—
PSRHBF prefunding fixed amount[2]		—		5,800		5,700
Normal cost of retiree health benefits[3]		3,305		—		—
Retiree health benefits premiums[4]		—		3,305		3,111
Total retiree health benefits expense	**$**	**4,260**	**$**	**9,105**	**$**	**8,811**

[1] Expense for the annual payment due by September 30, 2017, on the unfunded liability as calculated by OPM.

[2] Expense for the annual prefunding payments to the PSRHBF due on September 30, 2016, and 2015, upon which the Postal Service defaulted.

[3] Expense for the annual payment due to the PSRHBF by September 30, 2017, as calculated by OPM, for the actuarially-determined normal cost of retiree health benefits for current employees.

[4] Expense for the amount the Postal Service incurred for its share of retiree health benefit premiums. Beginning in 2017, the PSRHBF pays the Postal Service's share of retiree health benefit premiums.

NOTE 12 - WORKERS' COMPENSATION

Postal Service employees injured on the job are covered by FECA, and the Postal Service reimburses DOL for workers' compensation benefits paid to or on behalf of Postal Service employees, plus an administrative fee.

Workers' Compensation Liability

The Postal Service records a liability for its workers' compensation obligations for employees who have been injured on the job and are eligible for benefits, or their qualified survivors. To determine the actuarial valuation of new and existing cases, the Postal Service uses an estimation model that combines four generally-accepted actuarial valuation techniques based upon past claim-payment experience and exposure to claims as measured by total employee hours worked.

Changes in the liability are primarily attributable to the combined impacts of routine changes in actuarial assumptions, new compensation and medical cases, the progression of existing cases and changes in discount (interest) and inflation rates, including long-term COLA rates for compensation claims and medical rates for medical claims. These rates are updated as of the balance sheet date and factored into the model in accordance with GAAP.

To determine the fair value of the liability each quarter, the Postal Service first estimates the future total cost of workers' compensation claims based on the dates of claim-related injuries, frequency or severity of the injuries, the pattern of historical payments to beneficiaries and the expected trend in future costs. The Postal Service then calculates the amount that would need to be invested at current discount (interest) rates to fully fund the future total cost of claims, and this calculated present value is the fair value of workers' compensation liability.

An independent actuary assists in determining the liability for claims arising more than 15 years ago for years 1972 through 2001. The percentage increase in payments between 15-year old claims and closure of all claims is applied to the latest 15 years' estimates directly calculated within the estimation model for both compensation and medical losses.

The liability calculation is highly sensitive to changes in discount rates. For example, a 1% increase in the discount rate would decrease the September 30, 2017, liability and related expense by approximately $1.9 billion. Similarly, a 1% decrease in the discount rate would increase the September 30, 2017, liability and related expense by approximately $2.3 billion.

The following table details inflation and discount rates used to estimate the liability as of September 30, 2017, 2016 and 2015:

	2017	2016	2015
Compensation claims liability:			
Discount rate	2.5%	1.9%	2.4%
Long-term wage inflation	2.6%	2.6%	2.7%
Medical claims liability:			
Discount rate	2.5%	1.9%	2.4%
Historical medical inflation trend	1.4%	5.5%	5.7%

The Postal Service's total liability for workers' compensation was $17.9 billion and $20.0 billion as of September 30, 2017 and 2016, respectively. As of September 30, 2017 and 2016, the current portion of the liability was $1.5 billion and $1.4 billion, respectively, and the noncurrent portion of the liability was $16.4 billion and $18.6 billion, respectively, as reflected in the accompanying *Balance Sheets*.

Workers' Compensation Expense

The impacts of changes in discount rates and inflation rates, as well as the actuarial valuation of new cases and revaluation of existing cases, are components of total workers' compensation expense as recorded in the accompanying *Statements of Operations*. As described above, the Postal Service pays an administrative fee to DOL, which is also considered a component of workers' compensation expense.

Included in the workers' compensation expenses are prescription drug charges of which $41 million, $173 million and $99 million are for pharmaceutical compounding costs for the years ended September 30, 2017, 2016 and 2015, respectively. The Postal Service disputed these compounding cost charges and initially withheld $69 million from its October 2015 payment to DOL, which ultimately was paid in accordance with legal requirements, and withheld $151 million from its October 2016 payment to DOL. The disputed amount of $151 million from the 2016 invoice remains unpaid as of September 30, 2017, and 2016, and is included as part of the current liability within *Workers' compensation costs* in the accompanying *Balance Sheets.* The Postal Service did not withhold any amount from its October 2017 payment to DOL.

DOL implemented a new pharmaceutical compounding policy in July 2016, and in October 2016, it implemented a "Letter of Medical Necessity" requirement for compound pharmaceuticals. The Postal Service recorded a $549 million benefit for the year ended September 30, 2017, largely due to these changes in rules for pharmaceutical compounding.

The table below details the components of workers' compensation expense for the years ended September 30, 2017, 2016 and 2015:

(in millions)	2017	2016	2015
Impact of discount rate changes	$ (1,362)	$ 1,026	$ 809
Actuarial revaluation of existing cases	(1,138)	(113)	(886)
Costs of new cases	1,552	1,697	1,767
Administrative fee	151	72	70
Total workers' compensation (benefit) expense	**$ (797)**	**$ 2,682**	**$ 1,760**

2015 Workers' Compensation Change in Accounting Estimate

The Postal Service revised the calculation used in its valuation model to determine the actuarial revaluation of existing cases beginning in the first quarter of 2015. The impact of the change in estimate decreased the workers' compensation liability and corresponding expense by $353 million in the first quarter of 2015 and for the year ended September 30, 2015. This was considered a change in accounting estimate under GAAP. Management believes this change better reflects current injury trends and provides the best estimate of workers' compensation liability at that date.

NOTE 13 - REVENUE FORGONE

The Postal Service is required by law to offer below-cost postage prices to certain categories of mailers, including, but not limited to, non-profit organizations, blind individuals, local newspapers, publishers of educational material, and oversees mailers of absentee voting ballots. Between 1971, when the Postal Service became independent, and 1991, Congress reimbursed the Postal Service for the revenue it had "forgone" by offering below-cost postage prices to these mailers.

The *Revenue Forgone Reform Act of 1993* (the "RFA") phased in higher postage prices for certain of these mailers, retaining "free and reduced mail" only for the blind and for overseas absentee ballots. The RFA also authorized $1.2 billion to be paid to the Postal Service in 42 annual "installment" payments of $29 million each from 1994 through 2035 as reimbursement for revenue forgone during the RFA's 1991-to-1998 phase-in period.

Installment Payments

The Postal Service has recognized the present value of the installment payments as revenue and recorded a corresponding receivable, which is reduced each year that the installment payment is received. Although the RFA authorized the reimbursement, the Postal Service must submit an appropriation request to Congress each year in order to receive the annual revenue forgone payment.

During the years 2015 and 2016, Congress appropriated and paid $29 million for each of the respective annual installments. However for the years 2011 through 2014, and for the year 2017, some or all of these installment amounts were not appropriated and therefore not received by the Postal Service. The total unfunded amount was $134 million as of September 30, 2017, and is included within *Receivables, net* in the accompanying *Balance Sheets*. The Postal Service includes the total past-due installments in each annual appropriations request.

Outstanding receivables associated with the installment payments were $426 million and $405 million as of September 30, 2017, and 2016, respectively. These are not expected to be paid within one year due to the prolonged appropriation process, and are therefore classified as noncurrent within *Other assets* in the accompanying *Balance Sheets*.

The Postal Service recognized interest income of $21 million, $22 million, and $22 million for the years ended September 30, 2017, 2016 and 2015, respectively, for interest imputed on the outstanding receivable for the installment payments, and this imputed interest is included within *Interest and investment income* in the accompanying *Statements of Operations*.

Free and Reduced Mail

Congress has historically appropriated funds each year for free and reduced mail, however the annual appropriation may be higher or lower than the amount the Postal Service requests. At the end of each fiscal year, any difference between the actual amount Congress appropriated and actual amounts the Postal Service incurred to provide the subsidy during prior periods is reflected through an adjustment of the following year's funding request. Likewise, the Postal Service recognizes revenue based upon the actual amounts the Postal Service incurred to provide the subsidy during the year.

For free and reduced mail, the Postal Service recognized revenue of $48 million, $59 million and $63 million for the years ended September 30, 2017, 2016 and 2015, respectively, and this is included within *Operating Revenue* in the accompanying *Statements of Operations*. Outstanding receivables associated with free and reduced mail are $27 million and $14 million as of September 30, 2017, and 2016, respectively. The current portion of these receivables as of September 30, 2017, and 2016, are $19 million and $9 million, respectively, and are reflected within *Receivables, net* in the accompanying *Balance Sheets*. The noncurrent portion of these receivables as of September 30, 2017, and 2016, are $8 million and $5 million, respectively, and are reflected within *Other assets* in the accompanying *Balance Sheets*.

NOTE 14 - FAIR VALUE MEASUREMENT

The Postal Service defines fair value based on the price that would be received upon sale of an asset or the price that would be paid to transfer a liability between unrelated parties.

The carrying amounts of certain current assets and liabilities, including cash, accounts receivable, accounts payable, accrued expenses and the current portion of debt, approximate fair value due to their short-term nature. Assets within *Property and equipment, net* are recorded at cost and measured at fair value on a nonrecurring basis if they are determined to be impaired or classified as assets held for sale.

Noncurrent receivables and noncurrent debt are measured using inputs of the fair value hierarchy. This model prioritizes observable and unobservable inputs used to measure fair value, and consists of three broad levels, as defined in the authoritative literature:

- *Level 1* inputs include unadjusted quoted prices in active markets for identical assets or liabilities as of the balance sheet date.
- *Level 2* inputs include observable data, such as quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in inactive markets, observable data, other than quoted market prices for the asset or liability (i.e., interest rates, yield curves, etc.) and inputs that are derived from, or corroborated by, observable market data.
- *Level 3* inputs include unobservable data that reflect current assumptions about the judgments and estimates that market participants would use when pricing the asset or liability. These inputs are based on the best information available, including internal data.

Considerable judgment is involved in using this model to determine estimates of fair value and, accordingly, they may not necessarily be indicative of amounts that would be realized upon disposition of a specific asset or liability.

For the years ended September 30, 2017, and 2016, no significant transfers between *Level 1* and *Level 2* assets or liabilities occurred. The carrying amounts and fair value of these items are presented for disclosure purposes only in the following table:

	2017		2016	
(in millions)	**Carrying Amount**	**Fair Value**	**Carrying Amount**	**Fair Value**
Revenue forgone installment receivable*	$ 426	$ 496	$ 405	$ 527
Noncurrent portion of debt	$ 4,900	$ 5,210	$ 4,900	$ 5,492

* The carrying amount is included within *Other assets* (which includes items in addition to revenue forgone installment receivable) in the accompanying *Balance Sheets*.

The revenue forgone installment receivable qualifies as a financial instrument in accordance with authoritative literature. To calculate its fair value, the Postal Service recognizes the imputed interest it is owed as interest income and estimates the value of this receivable using the interest method, which converts future cash flows to a single discounted amount using interest rates for similar assets, which are considered *Level 2* inputs. The Postal Service then calculates the net present value of anticipated annual installment payments to be received, discounted by the 20-year U.S. Treasury Constant Maturity Rate, which was 2.63% and 1.99% as of September 30, 2017, and 2016, respectively.

The noncurrent portion of debt also qualifies as a financial instrument. Because no active market exists for the Postal Service's debt with the FFB, the fair value of the noncurrent portion of this liability has been estimated using expected future payments at risk-adjusted discount rates provided by the FFB, considered *Level 3* inputs.

NOTE 15 - QUARTERLY FINANCIAL DATA (UNAUDITED)

The following table sets forth the Postal Service's unaudited *Statements of Operations* for the quarterly periods ending September 30, 2017, and 2016:

(in millions)	2017 Quarter 1	2017 Quarter 2	2017 Quarter 3	2017 Quarter 4
Total revenue	$ 19,201	$ 17,268	$ 16,675	$ 16,492
Total operating expenses	17,716	17,787	18,776	17,931
Income (loss) from operations	1,485	(519)	(2,101)	(1,439)
Interest income (expense), net	(47)	(43)	(39)	(39)
Net income (loss)	**$ 1,438**	**$ (562)**	**$ (2,140)**	**$ (1,478)**

	2016 Quarter 1	2016 Quarter 2	2016 Quarter 3*	2016 Quarter 4
Total revenue	$ 19,359	$ 17,767	$ 17,718	$ 16,654
Total operating expenses	19,002	19,760	19,237	18,900
Income (loss) from operations	357	(1,993)	(1,519)	(2,246)
Interest income (expense), net	(50)	(47)	(48)	(45)
Net income (loss)	**$ 307**	**$ (2,040)**	**$ (1,567)**	**$ (2,291)**

* Includes a nearly $1.1 billion change in accounting estimate, which was reflected in operating results as an increase to total revenue and a decrease to loss from operations and net loss by the same amount.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

ITEM 9A. CONTROLS AND PROCEDURES

DISCLOSURE CONTROLS AND PROCEDURES

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

We carried out an evaluation, under the supervision and with the participation of management, including the Postmaster General and Chief Financial Officer, of the effectiveness of the design and operation of disclosure controls and procedures as of September 30, 2017. 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.

CHANGES IN INTERNAL CONTROL OVER FINANCIAL REPORTING

There were no changes in our internal controls over financial reporting during the quarter ended September 30, 2017, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

MANAGEMENT’S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

Our management is responsible for establishing and maintaining adequate controls over financial reporting. Internal control over financial reporting is a process to provide reasonable assurance regarding the reliability of our financial reporting for external purposes in accordance with GAAP. Internal control over financial reporting includes maintaining records that, in reasonable detail, accurately and fairly reflect our transactions, providing reasonable assurance that transactions are recorded as necessary for the preparation of our financial statements, providing reasonable assurance that receipts and expenditures of assets are made in accordance with management authorization and providing reasonable assurance that unauthorized acquisition, use, or disposition of assets that could have a material effect on our financial statements would be prevented or detected on a timely basis. Because of its inherent limitations, internal control over financial reporting is not intended to provide absolute assurance that a misstatement of our financial statements would be prevented or detected.

Management conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control – Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that our internal control over financial reporting was effective as of September 30, 2017.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

The Temporary Emergency Committee of the Board of Governors of the United States Postal Service

We have audited the United States Postal Service's internal control over financial reporting as of September 30, 2017, based on criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (2013 framework) (the COSO criteria). The United States Postal Service's management is responsible for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting included in the accompanying Management's Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on the United States Postal Service's internal control over financial reporting based on our audit.

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

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

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

In our opinion, the United States Postal Service maintained, in all material respects, effective internal control over financial reporting as of September 30, 2017, based on the COSO criteria.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the auditing standards generally accepted in the United States of America, and the standards applicable to financial audits contained in *Government Auditing Standards*, the balance sheets of the United States Postal Service as of September 30, 2017 and 2016, and the related statements of operations, changes in net deficiency, and cash flows for each of the three years in the period ended September 30, 2017 of the United States Postal Service and our report dated November 14, 2017 expressed an unqualified opinion thereon that included an explanatory paragraph regarding the United States Postal Service's ability to generate sufficient cash flow to meet all of its financial obligations throughout their fiscal year ending September 30, 2018.

/s/ Ernst & Young LLP

Tysons, Virginia
November 14, 2017

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

BOARD OF GOVERNORS

We are governed by an eleven-member Board which generally consists of our Postmaster General, Deputy Postmaster General and nine independent Governors. The Governors are appointed by the President with the advice and consent of the Senate. We currently have no Governors.

On October 30, 2017, the President nominated the following three individuals to serve as Governors on our Board:

- Calvin R. Tucker, to serve the remainder of a term expiring December 8, 2023;
- Robert M. Duncan, to serve the remainder of a seven-year term expiring December 8, 2018, and an additional term expiring December 8, 2025; and
- David Williams, to serve the remainder of a seven-year term expiring December 8, 2019.

The process of obtaining Senate confirmation of these nominees is in its earliest stage.

TEMPORARY EMERGENCY COMMITTEE

As referenced throughout this report, the Board is currently without a statutory quorum due to the failure of the President to make any new nominations or the Senate to act on past nominations for the Board. Given the loss of a statutory quorum, we filed a Federal Register notice that was published on December 16, 2014, which advised the public of actions taken during the November 2014 Board meeting to ensure that we continue to operate, notwithstanding the loss of a statutory Board quorum. During the November 2014 meeting, the Board adopted a resolution establishing the TEC, composed of the remaining members of the Board, to exercise those powers reserved to the Board that are necessary for continuity of operations. The only current members of the TEC are the Postmaster General and the Deputy Postmaster General.

The Governors also issued a resolution regarding the exercise of the powers vested solely in the Governor(s), as distinguished from the Board. The resolution clarifies that the inability of the Board to constitute a quorum does not inhibit or affect the authority of the Governor(s) then in office to exercise those powers vested solely in the Governor(s), upon the concurrence of an absolute majority of the Governor(s) then in office. For ease of use, references to the “Board” or the “Board of Governors” encompass the TEC as appropriate.

AUDIT AND FINANCE COMMITTEE

Given that we currently have no Governors, the Audit and Finance Committee (“Audit Committee”) is not currently functioning as designed, and the TEC is responsible for making decisions with respect to audit and finance matters that are within its authority. Absent the appointment of new Governors by the President with the advice and consent of the Senate, the TEC will continue to review Audit Committee matters during its regular meetings.

COMPENSATION AND MANAGEMENT RESOURCES COMMITTEE

Given that we currently have no Governors, the Compensation and Management Resources Committee (“Compensation Committee”) is also not currently functioning as designed, and the TEC is responsible for making decisions with respect to compensation matters that are within its authority. Absent the appointment of new Governors by the President with the advice and consent of the Senate, the TEC will continue to review Compensation Committee matters during its regular meetings consistent with its delegated authority.

EXECUTIVE OFFICERS

We had eight executive officers as of September 30, 2017, as per the schedule below:

Name and Age	Positions and Experience
Megan J. Brennan Age 55	74th Postmaster General, Chief Executive Officer and a member of the Board since February 2015; Vice Chairman of the Board since December 2015. Chief Operating Officer and Executive Vice President from December 2010 to February 2015. Previously, Vice President, Eastern Area Operations from December 2006 to December 2010, and Vice President, Northeast Area Operations from April 2005 to December 2006.
Ronald A. Stroman Age 65	20th Deputy Postmaster General and Government Relations Officer and member of the Board since April 2011. Served as Staff Director, Committee on Oversight and Government Relations at the U.S. House of Representatives, from 2009 to April 2011. Prior to this, served as Managing Director, Office of Opportunity and Inclusiveness, U.S. General Accounting Office, from 2001 to 2009.
David E. Williams Age 52	Chief Operating Officer and Executive Vice President since February 2015. Previously, Vice President, Network Operations from December 2006 to December 2010, and Vice President, Engineering from April 2005 to December 2006.
Kristin A. Seaver Age 49	Chief Information Officer and Executive Vice President since April 2016. Previously, Vice President, Capital Metro Area Operations from October 2013 to April 2016. Prior to that, served as Area Manager, Operations Support in the Northeast Area from October 2011 to 2013 and Area Manager, Operations Support in the Eastern Area from June 2007 to September 2011.
Joseph Corbett Age 57	Chief Financial Officer and Executive Vice President since 2009 (except for a brief period from June 20 through September 30, 2012, when he served as Acting Chief Information Officer and Executive Vice President). Founder and Managing Director of FinSol, LLC, a finance and accounting CFO services firm from 2005 to 2009. Consultant, Chief Financial Officer and Executive Vice President of BearingPoint, Inc., a U.S. government contracting, consulting, and systems integration company, from 2004 to 2005. Executive Vice President and Chief Financial Officer of Intelsat, Ltd., from 1998 to 2004 and Intelsat Controller from 1995 to 1998.
James P. Cochrane Age 62	Chief Customer and Marketing Officer and Executive Vice President since October 2016. Chief Marketing and Sales Officer and Executive Vice President from January 2016 to October 2016. Acting Chief Marketing and Sales Officer and Executive Vice President from April 2015 to January 2016. Chief Information Officer and Executive Vice President from October 2013 to April 2015. Prior to that, served as Vice President, Product Information from May 2010 to October 2013, and Vice President, Ground Shipping from September 2008 to May 2010.
Thomas J. Marshall Age 55	General Counsel and Executive Vice President since May 2013. Previously, Deputy General Counsel from March 2009 to May 2013. Prior to that, Managing Counsel, Civil Practice, from February 2004 to March 2009.
Jeffrey Williamson Age 42	Chief Human Resources Officer and Executive Vice President since March 2013. Previously, Vice President, Pricing from June 2012 to March 2013. Postal Service MIT Sloan Fellow Representative from May 2011 to June 2012. Manager, Performance and Field Operations from September 2009 to May 2011. Prior to that, Manager, Network Development and Support from October 2006 to September 2009.

CODE OF ETHICS

All of our employees are required to comply with the Standards of Ethical Conduct for Employees of the Executive Branch (“Standards”). The Standards are published in the Code of Federal Regulations (“CFR”) at *5 CFR Part 2635* and cover prohibitions and restrictions on the acceptance of gifts, conflicting financial interests, the obligation of all employees to perform their duties impartially, restrictions on the misuse of government positions, restrictions on certain outside activities and other related ethical obligations.

Our employees are also covered by a set of additional restrictions that apply only to Postal Service employees. These "Supplemental Standards" can be found at *5 CFR Part 7001* and focus on limitations on outside employment and outside business activities that could give rise to a conflict with their official duties.

The Standards and the Supplemental Standards contain many examples to help employees identify and resolve ethical issues. New employees receive ethics training at their orientation and ethics officials provide training throughout the year as required by law and as otherwise deemed appropriate. To ensure that all of our employees can receive timely and accurate ethics advice, we have established a dedicated ethics telephone helpline and an email address that is managed by ethics specialists.

Certain high level employees are also subject to the Senior Financial Managers' Code of Ethics. This Code of Ethics can be found on our website at: http://about.usps.com/who-we-are/financials/senior-financial-managers-code-of-ethics-07-29-2016.pdf.

ITEM 11. EXECUTIVE COMPENSATION

COMPENSATION DISCUSSION AND ANALYSIS

The Board establishes executive officer compensation and benefits, subject to the requirements and limitations of federal law. The Board has delegated to its Compensation Committee authority for initial review of management proposals related to compensation and benefits for executive officers. The Compensation Committee, which ordinarily meets several times throughout the year, is intended to be composed solely of presidentially appointed, Senate-confirmed Governors who are independent of our management. The Compensation Committee makes recommendations to the full Board for its review and approval. Since December 8, 2016, the Postal Service has not had any Governors, the Compensation Committee has not met and the TEC has performed the functions of the Compensation Committee to the extent necessary for the continuity of operations.

Set forth in Title 39 of the U.S. Code, federal law governing us provides that compensation and benefits for all of our officers shall be comparable to the compensation and benefits paid for comparable levels of work in the private sector of the economy. We are the second largest civilian employer in the nation, with approximately 644,000 career and non-career employees as of the end of 2017. We operate approximately 231,000 motor vehicles and approximately 31,000 retail units. In 2017, we delivered 149.5 billion pieces of mail, almost half of the world's mail, and generated approximately $70 billion in revenue. In 2017, we ranked 99th in *Fortune* magazine's listing of *Fortune Global 500* companies. By way of comparison, two of our largest competitors ranked 138th and 180th on this list. If we were listed on the *Fortune 500* annual ranking of America's largest corporations, we would be ranked 37th. The same two of our largest competitors are ranked 46th and 58th on that list.

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

Although our governing law provides that executives and others should be compensated at a level comparable to the private sector, the law does not afford the Board or the Governor(s) the tools to achieve this standard of compensation. Compensation for our executive officers remains significantly below that of similarly-ranked senior executives in the private sector.

The law imposes three different caps on compensation for our employees. The first cap provides that no officer or employee may be paid compensation "at a rate in excess of the rate for level I of the Executive Schedule under *Section 5312* of Title 5 of the U.S. Code *39 U.S.C. §1003(a)*. In calendar year 2017, the upper limit on federal salaries rose 1% to $207,800.

With the approval of the Board, we may develop a program to award a bonus or other reward in excess of the compensation cap discussed above, as long as the total compensation paid to the officer in a year does not "exceed the total annual compensation payable to the Vice President [of the United States] under [*3 U.S.C. §104*] as of the end of the calendar year in which the bonus or award is paid." *39 U.S.C. §3686(a)-(b)*. In calendar year 2017, this cap rose 1% to $240,100. The Board may approve a program allowing for bonuses or other rewards if it determines, for the annual appraisal period involved, that the performance appraisal system for impacted employees makes meaningful distinctions based on relative performance.

In addition, the Board may allow up to 12 of our officers or employees in critical senior executive or equivalent positions to be paid total annual compensation up to "120 percent of the total annual compensation payable to the Vice President [of the United States] under [*3 U.S.C. §104*] as of the end of the calendar year in which such payment is received." *39 U.S.C. §3686 (c)*. Based on the Vice President's salary for calendar year 2017, the compensation cap for calendar year 2017 was $288,120.

By law, our employees, including executive officers, are entitled to participate in either CSRS or FERS, depending on when their federal employment began. As applicable to our officers, these retirement systems are described later in this *Compensation Discussion and Analysis*. In addition, in order to remain competitive with comparable employment in private industry and other parts of the U.S. government, our policy also authorizes certain additional benefits for all of our officers, including executive officers. Other than changes required by law, the Board must authorize increases to benefits for officers.

COMPENSATION PHILOSOPHY AND OBJECTIVES

The Board recognizes that a significant disconnect exists between the comparability requirement and the compensation caps in the law governing us and that the various compensation caps do not enable the Board to provide compensation and benefits for our executive officers that are fully comparable to those in the private sector. This is especially true given our current financial challenges. The Board also recognizes that many of the compensation and benefit tools available in the private sector, such as equity ownership, are not available to us, given our status as part of the U.S. government. These limitations make it more difficult for us to competitively recruit in the marketplace for executive officers and to retain current executive officers. We have taken significant steps, described elsewhere in this report, to reduce costs and generate revenue. However, we have sought and continue to need significant legislative and regulatory change in order to have greater flexibility to reduce costs, generate new revenue and return to financial stability.

In an attempt to achieve some level of comparability within the confines of the law, the Board designed a compensation system intended to balance an executive's annual salary with the ability to earn additional compensation by meeting performance goals and objectives; however, because of the compensation caps discussed above, a portion of this compensation might need to be deferred.

At the start of calendar year 2017, the compensation system operated pursuant to its terms, and eligible non-executive officers received an increase in their basic compensation and a performance lump-sum payment. Increases in basic compensation in calendar year 2017 were dependent upon fiscal year 2016 performance, and averaged 3%. The amount of the performance lump-sum payments issued in calendar year 2017 was also based upon fiscal year 2016 performance, and averaged 7%. However, uncertainty about future payments and the viability of the compensation system continues to negatively impact our ability to retain and recruit talented employees, including executives and executive officers.

Within the confines of its legislative authority and our financial constraints, the Board's compensation philosophy is that:

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

THE COMPENSATION PROGRAM

In 2007, with the assistance of an independent consulting firm specializing in executive compensation, the Compensation Committee recommended and the Board approved a salary band for the Postmaster General to be set at the legislative salary cap. In doing so, the Board's objectives were to design a compensation program that optimized the legislative flexibility granted by the PAEA, improve external marketplace competitiveness and honor legislative constraints and existing pay ranges.

For the other executive officers, the Board set pay bands based on salary relationships of comparable executive officers in the external market. In general, the Board has maintained these types of pay band relationships since 2007.

The Governor approved Postmaster General Megan J. Brennan's salary at the legislative cap for calendar year 2017.

Over the years, the Governor(s) have authorized the Postmaster General to establish salaries for the other executive officers within the confines of the salary ranges established by the Governor(s). As noted above, for calendar year 2017, after reviewing recommendations from the Postmaster General, the Governor approved the application of the PFP system according to its terms and approved an increase in the salary ranges by 1%.

In 2017, we continued to employ a national performance assessment program ("NPA") to set annual performance goals and metrics that vary among executive officers and are weighted to reflect appropriately the degree to which an executive is able to influence our overall performance. The annual NPA metrics and targets generally take into consideration our performance during the prior fiscal year and the particular challenges that we anticipate having to face during the following year. The NPA places emphasis on measurable financial and service performance indicators. The Governor also set individual metrics and targets for the Postmaster General and Deputy Postmaster General and authorized the Postmaster General to establish individual metrics and targets for other officers.

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

Our economic challenges have continued to persist over the last several years and these challenges have caused uncertainty as to whether officer salary increases or performance bonuses will be awarded on a year-to-year basis. This uncertainty is largely driven by our flawed business model which limits our ability to be financially successful, and which can only be corrected by comprehensive postal legislation and regulatory reform.

The Governor(s) in the past have repeatedly stated that this situation must be remedied in the near future, and are concerned that if this situation continues much longer, it will further erode our ability to retain highly-qualified individuals as officers and to recruit the best qualified individuals from the marketplace, if external hiring is deemed to be the best solution to fill critical officer vacancies. Additionally, our financial constraints, which largely are the products of structural defects that only Congress can remedy, have prevented us from fully complying with the statutory mandate that our officers be paid in a manner comparable with their private-sector counterparts.

We continued to use the NPA process to measure performance during 2017. NPA performance goals and rewards fall into several categories that an officer may directly influence, such as service, efficiency, employee satisfaction and productivity, as well as those that are more susceptible to being impacted by general economic conditions, such as revenue generation.

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

Once the goals and indicators are established, executive officers are advised as to what is expected of them in terms of performance during the year, how their performance will impact us, and, in years when incentives are authorized, the potential level of performance-based incentives they can expect depending on their individual performance and our performance as a whole. Under this program, an individual executive officer can receive a numerical rating within a range of 1 to 15 depending on how we perform on the national indicators and the individual's performance, as determined by the Postmaster General.

The system is designed to operate as follows: an individual executive officer's performance rating would make the officer eligible for an increase to base salary, as well as for a performance-based lump-sum payment. Due to statutory cap limitations, increases to the maximum of the salary range for executive officers would generally follow the percentage increase in the applicable statutory cap for any given year. Any salary increases for executive officers are limited by these maximums and are solely performance based, as determined by the Postmaster General. Lump-sum incentive payments would be tied to the Postmaster General's rating of the executive officer's performance, based on the degree to which the individual achieved previously set individual goals and metrics. The Postmaster General's discretion on PFP incentives for executive officers in a given year is limited by our overall performance on NPA goals and metrics. Generally, officer performance scores must average to our overall NPA performance score for the fiscal year. Salary increases, if any, are generally determined after the end of the fiscal year, and any new salaries become effective for the following calendar year.

COMPONENTS OF OFFICER COMPENSATION AND BENEFITS

Base Salary

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

Annual Incentive

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

Other Compensation Incentives

Executive officers are also eligible for recognition awards for specific activities that reflect a high degree of leadership. The Governor authorized the Postmaster General to specify a limited budget for awards to officers in 2017 for exceptional accomplishments during the year. In addition, executive officers are eligible for recruitment, relocation and retention incentives designed to attract and retain highly talented and marketable individuals in key positions. Payments of some of these incentives may be deferred, in whole or in part, due to the compensation limits imposed on our employees as more fully discussed above.

Retirement Annuities

Officers are covered either by CSRS or FERS. Both systems have a defined benefit component and a defined contribution component. CSRS and FERS service is creditable for Medicare coverage. FERS service is creditable for Social Security.

CSRS Defined Benefit

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

FERS Defined Benefit

The FERS Basic Benefit annuity is based on 1.0% of high-3 salary per year of service, or 1.1% for retirement at age 62 with at least 20 years of service. Optional retirement thresholds are the Minimum Retirement Age ("MRA") of 55 to 57 (depending birth year) with 30 years of service, age 60 with 20 years of service, age 62 with five years of service, or MRA with ten years of service (at a reduced benefit), with a requirement of completing at least five years of creditable civilian service. Employees who retire at MRA with 30 years of service, or at age 60 with 20 years of service, receive a retirement supplement approximating the value of Social Security benefits attributable to federal service; this benefit is paid until age 62. Beginning at age 62, the annuity is indexed to CPI, fully when the CPI increase is 2% or less, at 2% when the CPI increase is between 2% and 3%, and at CPI minus 1% when the CPI is at least 3%. Disability, early retirement, deferred and survivor benefits are available.

Defined Contribution

The TSP has a component that mirrors traditional 401(k) plans and an option similar to "Roth" plans. CSRS and FERS employees may contribute up to the indexed IRS maximum ($18,000 in calendar year 2017). We do not make TSP contributions for CSRS employees. For FERS employees, we make an automatic contribution of 1% of basic pay and match a percentage of employee contributions for up to an additional 4% of basic pay, for a total employer contribution of up to 5% of basic pay. Employees who will be at least age 50 in the year of contribution may make a separate catch-up contribution up to the indexed IRS maximum ($6,000 in calendar year 2017). TSP investment options are a government securities fund; index funds that track the Barclays Capital Aggregate Bond Index, the S&P 500, the Dow Jones U.S. Completion TSM Index, and the Morgan Stanley Capital International EAFE (Europe, Australasia and Far East) stock index; and lifecycle funds.

Supplemental Non-Qualified Deferred Compensation

Where appropriate and on a highly selective basis, we have offered supplemental non-qualified deferred compensation as a recruitment or retention tool.

Life Insurance

Officers are entitled to *Basic* group life insurance coverage under the Federal Employees Group Life Insurance ("FEGLI") program in the amount of their annual basic salary, rounded up to the next $1,000, plus $2,000. If *Basic* coverage is held, an officer will also receive an additional $10,000 coverage (*Option A*) and *Option B* coverage up to three times their salary. We pay all premiums for *Option A*, *Option B* and *Basic* coverage.

At their own expense, officers may elect additional *Option B* coverage in an amount equal to two times their salary, or *Option C*, family optional insurance coverage, of up to five multiples of $5,000 for their spouse and $2,500 for each eligible dependent child under age 22. Officers continuously covered under FEGLI for the five years of service immediately preceding retirement, or since the first opportunity to enroll, may continue coverage during retirement (if entitled to an immediate annuity). We pay retired officers an actuarially determined lump sum to cover the cost of *Option A* premiums during retirement.

Health Benefits

We participate in FEHB, which allows all career employees to enroll in one of a number of *Self-Only*, *Self-Plus-One* or *Self and Family* health benefit plans offered. We pay a portion of the cost of the premium for our officers and executives. In 2017, our share of the premium was 72% of the federal weighted average premium, limited to not more than 75% of the total premium for any given plan, and enrolled officers and executives paid the balance of the premium for the plan they selected. Employees who retire with immediate entitlement to an annuity are eligible to continue FEHB coverage into retirement, as long as they have participated in FEHB for the five years preceding their retirement or since their first opportunity to enroll.

Other Benefits

To remain competitive in the marketplace, we offer the following additional benefits to our executive officers: periodic physical examinations or *Wellness* reimbursement incentive, parking, financial planning, retirement counseling services and membership in up to two airline clubs per year. In November 2015, the Governors, in connection with their annual review of the compensation and benefits for the Postmaster General and Deputy Postmaster General, clarified and updated their policies to provide that the Postmaster General and Deputy Postmaster General are entitled to a separation payment in an amount of one year's salary if either is asked to separate from the Postal Service for any reason other than cause and they are otherwise not eligible for immediate retirement (not including early retirement, discontinued service retirement, or retirement at the minimum retirement age with less than 30 years of service). Severance may be paid in a single lump-sum payment or in bi-weekly payments following the date of separation from the Postal Service.

COMPENSATION AND MANAGEMENT RESOURCES COMMITTEE REPORT

Because the Compensation Committee currently does not have any members, the TEC has reviewed and discussed this *Compensation Discussion and Analysis,* and, based on such review and discussions, the TEC has approved the inclusion of this *Compensation Discussion and Analysis* in this report.

Signature	Title
/s/ Megan J. Brennan Megan J. Brennan	Board Member, Postmaster General and Chief Executive Officer
Signature	**Title**
/s/ Ronald A. Stroman Ronald A. Stroman	Board Member and Deputy Postmaster General

SUMMARY COMPENSATION TABLE

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

Name and principal position	Fiscal year	Salary[2]	Bonus[3]	Non-equity incentive plan compensation[4]	Change in pension value and non-qualified deferred compensation earnings[5]	All other compensation	Total
Megan J. Brennan, *Postmaster General & Chief Executive Officer*[1]	2017	$ 286,979	$ —	$ 49,917	$ 213,375	$ 28,146	$ 578,417
	2016	286,137	—	—	590,846	27,801	904,784
	2015	266,981	—	9,500	110,429	28,381	415,291
Joseph Corbett, *Chief Financial Officer & Executive VP*	2017	256,413	1,315	45,578	78,514	22,130	403,950
	2016	258,195	—	35,000	45,908	21,269	360,372
	2015	246,404	—	44,700	40,634	21,932	353,670
James P. Cochrane, *Chief Customer and Marketing Officer & Executive VP*	2017	256,872	1,315	15,896	212,277	25,512	511,872
	2016	257,359	10,000	—	254,838	14,019	536,216
	2015	239,702	—	9,400	279,722	10,563	539,387
Ronald A. Stroman, Deputy Postmaster General & Chief Government Relations Officer	2017	263,516	1,315	16,184	189,455	14,065	484,535
	2016	264,677	—	—	27,501	14,237	306,415
	2015	252,590	—	9,900	26,341	14,903	303,734
David E. Williams Jr., *Chief Operating Officer & Executive VP*	2017	253,087	1,315	19,198	542,982	19,754	836,336
	2016	251,173	10,000	—	115,441	19,282	395,896
	2015	223,458	—	7,600	88,153	17,542	336,753

[1] Ms. Brennan was appointed Postmaster General and Chief Executive Officer as of February 2, 2015.

[2] 2016 salary includes one additional pay period of earnings due to a 27th payday which occurred on December 31, 2015.

[3] Mr. Corbett, Mr. Cochrane, Mr. Stroman and Mr. Williams received Officer Recognition Awards in December 2016. Mr. Cochrane and Mr. Williams received a Postmaster General's award in 2016.

[4] Amounts reflect the performance-based incentive compensation awarded to executive officers for performance in prior fiscal years; as noted above, this incentive compensation was not awarded for 2015. The amount shown for Mr. Corbett also reflects the lump sum performance retention payment required by his employment agreement. Any amounts that could not be paid to an executive officer, due to the compensation cap or their contract, were deferred for future payment and are also reflected in the non-qualified deferred compensation table below.

[5] Mr. Cochrane and Mr. Stroman participate in CSRS. Ms. Brennan, Mr. Corbett and Mr. Williams participate in FERS. The calculation of retirement annuities under CSRS and FERS is explained in the Pension Benefits table, the associated note and in the *Retirement Annuities* section of *Compensation Discussion and Analysis*. The amounts shown for each of these individuals represent the change in annuity value from the prior year. In June 2017, the OPM Board of Actuaries adopted new economic and demographic assumptions for FERS and CSRS. The increase can also include changes in eligibility conditions that allow members to receive benefits earlier. "Non-qualified deferred compensation earnings" is defined as above-market earnings on deferred income. There were no reportable amounts of non-qualified deferred compensation earnings for the named executive officers in 2017, 2016 or 2015, with the exception of Mr. Corbett, whose above-market earnings on deferred income were $1,992 in 2017, $1,647 in 2016, and $1,320 in 2015.

GRANTS OF PLAN-BASED AWARDS

The following table presents information regarding potential non-equity incentive awards to the named executive officers for 2017. Whether a named executive officer receives an award and, if so, the amount of an award for 2017 will depend on both the Postal Service's and the individual's performance.

	Estimated future payouts under non-equity incentive plan awards			
Name	Grant date	Threshold	Target	Maximum
Megan J. Brennan	November 2017	$ 11,505	$ 34,514	$ 107,858
Joseph Corbett	November 2017	10,371	31,114	97,230
James P. Cochrane	November 2017	10,371	31,114	97,230
Ronald A. Stroman	November 2017	10,668	24,003	100,013
David E. Williams Jr.	November 2017	10,289	30,866	96,458

Note: The PFP program relies on a 15-point scale with clearly defined and transparent corporate goals. The PFP target in any given year is set at a rating of 6. The maximum threshold for payment is set at a rating of 15. Individual ratings vary but the corporate score is used as the regulator. Given our financial condition, any individual award is unlikely to exceed the target amount.

PENSION BENEFITS

The following table shows the present value of accumulated pension benefits payable to the named executive officers as of September 30, 2017:

Name	Plan name	Number of years credited service	Present value of accumulated benefit
Megan J. Brennan	FERS Annuity	31	$ 1,681,837
Joseph Corbett	FERS Annuity	9	316,128
James P. Cochrane	CSRS Annuity	43	3,630,534
Ronald A. Stroman	CSRS Annuity	39	3,187,967
David E. Williams Jr.	FERS Annuity	30	1,281,276

Note: All named executive officers are eligible for CSRS or FERS. These plans are described in the *Retirement Annuities* section within *Compensation Discussion and Analysis*. The present value of the accumulated CSRS or FERS benefit represents the value of the pension over the individual's actuarial lifetime, as of September 30, 2017. Mr. Cochrane and Mr. Stroman participate in CSRS, and Ms. Brennan, Mr. Corbett and Mr. Williams participate in FERS. Mr. Cochrane and Mr. Stroman are eligible for retirement, the calculation of which is described in the *Retirement Annuities* section within *Compensation Discussion and Analysis*. The valuation for Ms. Brennan, Mr. Corbett and Mr. Williams assumes that they have satisfied vesting requirements for retirement; however, because of their current tenure with the Postal Service, their retirement annuities have not fully vested.

NON-QUALIFIED DEFERRED COMPENSATION

The following table presents contributions to, and earnings on, the named executive officers' deferred compensation for 2017:

Name	Executive contributions in 2017[1]	Aggregate earnings in 2017[2]	Aggregate withdrawals / distributions in 2017	Aggregate balance at September 30, 2017
Megan J. Brennan	$ 49,917	$ 2,197	$ —	$ 67,861
Joseph Corbett	35,000	13,562	—	325,317

[1] This column represents amounts deferred due to the compensation cap or contract agreements. The amount shown for Mr. Corbett reflects the lump-sum performance retention payment required by his employment agreement which has been deferred.

[2] We calculate interest on deferred compensation semi-annually at 5.0% per year for Mr. Corbett per his contract, others are calculated at the Federal Long-Term Rate; 4.08% in 2017. Interest is prorated from the relevant pay period of the deferral.

POTENTIAL PAYMENTS UPON TERMINATION

The Postmaster General and all of the other named executives are subject to the standard policies governing CSRS or FERS, as described in the *Compensation Discussion and Analysis*. The present value of these CSRS and FERS benefits are found in the Pension Benefits table in the *Executive Officer Compensation* section of this report. The information below describes and quantifies certain compensation, in addition to that due pursuant to CSRS or FERS, that would become payable under existing plans and arrangements if the named executive officer's employment had terminated on September 30, 2017. Additionally, pursuant to statutes and regulations generally applicable to federal employees, the named executives would be entitled to receive the federal employer's standard contribution toward retiree health benefits, in the event they have qualifying service and participated in FEHB for the requisite period of time prior to retiring.

DEFERRED COMPENSATION

All federal employees, including our employees, are subject to annual compensation limits established pursuant to federal statutes and regulations. When amounts earned by federal employees cannot be paid because of these compensation limits, these payments are deferred until a year in which their payment would not cause total annual compensation paid to exceed the compensation limit, or the year in which an employee leaves federal service, whichever occurs first. Named executive officers appearing in the non-qualified deferred compensation table in the *Executive Officer Compensation* above have deferred compensation in the amounts indicated therein. These amounts would have been paid to them in a lump sum or pursuant to their contract with us following their departure, had they ended their employment with us on September 30, 2017.

Mr. Corbett's employment agreement provides for deferred incentives linked in part to his performance. Mr. Corbett began accruing deferred performance-based compensation at the end of 2010. When Mr. Corbett concludes his employment with us, or on October 22, 2019, if that date is later than Mr. Corbett's departure from the Postal Service, his deferred compensation will be paid to him in three approximately equal annual installments.

SUPPLEMENTAL PENSION BENEFIT

The Governor(s) have not authorized a supplemental pension benefit for any executive officer at this time.

SEVERANCE PAYMENT

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

INSURANCE BENEFIT

The Governor(s) have not authorized supplemental insurance benefits for any executive officer at this time. The insurance benefits to which all of our executive officers are entitled are described above.

OUTPLACEMENT ASSISTANCE

The Governor(s) have not authorized any outplacement assistance for any executive officer at this time.

ACCRUED ANNUAL LEAVE

All of our employees are entitled to receive and accrue paid days off, known as annual leave. Upon their separation from the Postal Service, all employees, including the named executive officers, are entitled to be paid, in a lump sum, the value of all accrued annual leave.

The table below shows the accrued value of the annual leave of the named executive officers as of September 30, 2017:

Name	Value of accrued annual leave
Megan J. Brennan	$ 139,800
Joseph Corbett	103,712
James P. Cochrane	65,443
Ronald A. Stroman	36,928
David E. Williams Jr.	—

GOVERNORS COMPENSATION

The following table presents information regarding the compensation of the Governors during 2017:

Name[1]	Fees earned or paid in cash	All other compensation	Total
James H. Bilbray[2]	$ 7,767	$ 581	$ 8,348

[1] Each Governor receives a basic stipend of $30,000 per year plus $300 per day for not more than 42 days of meetings each year.
[2] The term of Governor Bilbray expired on December 8, 2016.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

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

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS AND DIRECTOR INDEPENDENCE

CERTAIN TRANSACTIONS

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

DIRECTOR INDEPENDENCE

Our Governors are appointed by the President with the advice and consent of the Senate, and are independent based on the New York Stock Exchange definition of independence. At this time, however, the Board has no presidentially appointed Governors.

ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Annually, the Audit Committee reviews and pre-approves the audit services to be provided by our independent auditors. The Audit Committee must approve other specific services before the independent auditors may perform such services. The Audit Committee also has delegated to the Audit Committee Chairman pre-approval authority with respect to permitted services, provided that any pre-approval decisions must be reported to the Audit Committee at its next scheduled meeting. Because we do not have any Governors, the TEC is performing the functions of the Audit Committee to the extent necessary for continuity of operations.

Audit fees totaled approximately $10.2 million and $9.8 million for the years ended September 30, 2017, and 2016, respectively. Audit fees include fees for professional services associated with the annual financial statement audit, the reviews of our quarterly reports on Form 10-Q and testing of our internal control over financial reporting. We did not incur any other fees from our independent auditors.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

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

1. Financial Statements

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

2. Financial Statement Schedules

None.

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

3. Exhibits

10.1	Employment/Compensation Contract with Joseph Corbett, Chief Financial Officer (filed with the Postal Regulatory Commission on January 29, 2009, as Exhibit No. 10.1 to the Current Report on Form 8-K).
31.1	Certificate of United States Postal Service's Principal Executive Officer Adopted Pursuant to Section 302 of the *Sarbanes-Oxley Act of 2002*.
31.2	Certificate of United States Postal Service's Principal Financial Officer Adopted Pursuant to Section 302 of the *Sarbanes-Oxley Act of 2002*.
32.1	Certificate of United States Postal Service's Principal Executive Officer Adopted Pursuant to Section 906 of the *Sarbanes-Oxley Act of 2002*.
32.2	Certificate of United States Postal Service's Principal Financial Officer 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/Megan J. Brennan
Megan J. Brennan
Postmaster General and Chief Executive Officer

Date: November 14, 2017

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

Date: November 14, 2017

Pursuant to the requirements of the *Postal Accountability and Enhancement Act of 2006*, this Report has been signed below by the following persons on behalf of the United States Postal Service and in the capacities indicated as of November 14, 2017.

Signature	Title
/s/ Megan J. Brennan Megan J. Brennan	Board Member, Postmaster General and Chief Executive Officer
/s/ Ronald A. Stroman Ronald A. Stroman	Board Member and Deputy Postmaster General
/s/ Joseph Corbett Joseph Corbett	Chief Financial Officer and Executive Vice President (Principal Financial Officer)
/s/ Maura A. McDevitt Maura A. McDevitt	Vice President, Controller (Principal Accounting Officer)

EXHIBIT 31.1

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

I, Megan J. Brennan, certify that:

1. I have reviewed this Annual Report on Form 10-K of the United States Postal Service ("Postal Service");

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

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

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

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

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

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

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

5. The Postal Service's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Postal Service's independent registered accounting firm and the Audit and Finance Committee of the Postal Service's Board of Governors (or persons performing the equivalent functions):

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

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

Date: November 14, 2017

/s/Megan J. Brennan

Megan J. Brennan

Postmaster General and Chief Executive Officer

EXHIBIT 31.2

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

I, Joseph Corbett, certify that:

1. I have reviewed this Annual Report on Form 10-K of the United States Postal Service ("Postal Service");

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

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

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

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

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

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

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

5. The Postal Service's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the Postal Service's independent registered accounting firm and the Audit and Finance Committee of the Postal Service's Board of Governors (or persons performing the equivalent functions):

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

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

Date: November 14, 2017

/s/Joseph Corbett

Joseph Corbett
Chief Financial Officer and Executive Vice President

EXHIBIT 32.1

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

In connection with the Annual Report of the United States Postal Service (“Postal Service”) on Form 10-K for the period ended September 30, 2017, (the “Report”), I, Megan J. Brennan, 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: November 14, 2017

/s/Megan J. Brennan

Megan J. Brennan
Postmaster General and Chief Executive Officer

EXHIBIT 32.2

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

In connection with the Annual Report of the United States Postal Service ("Postal Service") on Form 10-K for the period ended September 30, 2017, (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: November 14, 2017

/s/Joseph Corbett

Joseph Corbett
Chief Financial Officer and Executive Vice President