

(English Translation)

Audit Report with Financial Report

(The 29th fiscal year from January 1, 2018 to December 31, 2018)

VOLKSWAGEN FINANCIAL SERVICES JAPAN LTD.

Independent Auditor's Report
(English Translation*)

February 25, 2019

To the Board of Directors of
VOLKSWAGEN FINANCIAL SERVICES JAPAN LTD.:

PricewaterhouseCoopers Aarata LLC
Hideaki Endo, CPA
Designated limited liability Partner
Engagement Partner

We have audited, pursuant to Article 436 (2) (i) of the Companies Act of Japan, the accompanying financial statements, which comprise the balance sheet, profit and loss statement, statement of changes in net assets and notes to the financial statements, and the supplementary schedules of VOLKSWAGEN FINANCIAL SERVICES JAPAN LTD (hereinafter referred to as the "Company") for the 29th fiscal year from January 1, 2018 to December 31, 2018.

Management's Responsibility for the financial statements and the supplementary schedules

Management is responsible for the preparation and fair presentation of the financial statements and the supplementary schedules in accordance with accounting principles generally accepted in Japan, and for such internal control as management determines is necessary to enable the preparation of the financial statements and the supplementary schedules that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on the financial statements and the supplementary schedules based on our audit. We conducted our audit in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and the supplementary schedules are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements and the supplementary schedules. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements and the supplementary schedules, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements and the supplementary schedules in order to design audit procedures that are appropriate in the circumstances, while the purpose of the financial statements audit is not to express an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as examining the overall presentation of the financial statements and the supplementary schedules.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements and the supplementary schedules referred to above present fairly, in all material respects, the financial position and its financial performance for the period covered by the financial statements and the supplementary schedules in accordance with accounting principles generally accepted in Japan.

Conflict of Interest

We have no interest in or relationship with the Company which should be disclosed pursuant to the provisions of the Certified Public Accountants Act of Japan.

* The original audit report is in Japanese. This English translation is for readers' convenience and reading this translation is not a substitute for reading the original audit report in Japanese.

Financial Statements

(The 29th fiscal year from January 1, 2018 to December 31, 2018)

VOLKSWAGEN FINANCIAL SERVICES JAPAN LTD.

Balance Sheet

(As of December 31, 2018)

(JPY in thousands)

Account item	Amount	Account item	Amount
Assets		Liabilities	
Current assets	359,839,745	Current liabilities	195,572,777
Cash on hand and in banks	4,572,369	Accounts payable - trade	4,376,357
Accounts receivable - trade	26,802,504	Short-term borrowings	83,000,000
Installment accounts receivable	276,126,687	Commercial papers	23,999,243
Lease investment assets	28,902,886	Bonds payable within one year	19,000,000
Short-term loans receivable	14,860,196	Payable under fluidity installment accounts receivable	48,377,750
Advance payments	7,345,218	Liabilities from leasing business	292,430
Prepaid expenses	52,381	Accounts payable - other	297,553
Accounts receivable - other	2,032,884	Accrued expenses	782,724
Others	1,634	Income taxes payable	759,690
Allowance for bad debts	210,646	Advances received	1,081,478
Allowance for residual value	646,371	Deposits payable	353,934
Fixed assets	5,392,164	Deferred installment income	12,069,915
Tangible fixed assets	1,338,254	Allowance for sales incentive	972,138
Buildings	179,703	Bonus allowance	128,734
Building equipment	87,835	Provision for point card certificates	990
Structures	7,170	Others	79,836
Machinery and equipment	7,369		
Vehicles and cars	73,319	Long-term liabilities	150,366,840
Furniture, fixtures and tools	136,993	Bonds	13,000,000
Land	845,862	Long-term borrowings	78,000,000
Intangible fixed assets	802,637	Long-term payable under fluidity installment accounts receivable	56,078,378
Software	802,637	Deposits received for guarantees	2,709,602
Telephone rights	0	Retirement reserve allowance	293,111
Investments and other assets	3,251,271	Retirement reserve allowance for directors	125,508
Stocks of affiliated companies	20,000	Asset retirement obligations	138,652
Long-term loans receivable	444,753	Others	21,586
Long-term guarantee money deposited	1,245,066	Total liabilities	345,939,617
Deferred tax assets	1,548,855	Equity	
Allowance for bad debts	7,403	Shareholders' equity	19,309,772
Total assets	365,231,909	Capital stock	1,010,000
		Earned surplus	18,299,772
		Legal reserve	252,500
		Retained earnings and others	18,047,272
		Retained earnings carried forward	18,047,272
		Valuation and translation adjustments	17,481
		Deferred gains and losses on hedges	17,481
		Total equity	19,292,291
		Total liabilities & equity	365,231,909

Income Statement

(from January 1, 2018 to December 31, 2018)

(JPY in thousands)

Account item	Amount	
Operating revenues		
Retail financing loan income	7,406,157	
Dealer financing income	328,807	
Finance leasing income	772,282	
Real estate rental income	235,630	
Credit card commission income	7,181	
Insurance commission income	734,369	
Others	259,653	9,744,083
Operating expenses		
Interest expenses	828,626	
Interest expenses (bond)	157,444	
Selling, general and administrative expenses	5,225,214	6,211,285
Operating income		3,532,797
Non-operating income		
Interest income	137	
Reversal of allowance for bad debts	89,457	89,595
Ordinary income		3,622,392
Extraordinary gains		
Gains from sales of fixed assets	2,158	2,158
Extraordinary loss		
Losses from disposing of fixed assets	209,187	
Losses from sales of fixed assets	1,453	210,641
Net income before taxes		3,413,909
Income taxes-current	1,122,168	
Income taxes-deferred	11,564	1,110,604
Net income		2,303,305

Statement of Changes in Equity

(from January 1, 2018 to December 31, 2018)

(JPY in thousands)

	Shareholders' equity					Valuation and translation adjustments	Total equity
	Capital stock	Earned surplus			Total shareholders' equity	Deferred gains and losses on hedges	
		Legal reserve	Retained earnings and others (Note)	Total earned surplus			
Beginning balance	1,010,000	252,500	15,743,967	15,996,467	17,006,467	△ 47,477	16,958,989
Changes of items during the period							
Net income			2,303,305	2,303,305	2,303,305		2,303,305
Net changes of items other than shareholders' equity						29,996	29,996
Total changes of items during the period			2,303,305	2,303,305	2,303,305	29,996	2,333,301
Ending balance	1,010,000	252,500	18,047,272	18,299,772	19,309,772	△ 17,481	19,292,291

Note: "Retained earnings and others" are all from retained earnings carried forward.

Summary of significant accounting policies

1. Valuation standard and method for assets

- (1) Stock of affiliated companies: Cost method
- (2) Derivatives: Market value method

2. Method of depreciation of fixed assets

- (1) Tangible fixed assets: Declining-balance method

However, buildings are depreciated on a straight-line basis over their estimated useful lives, with either the estimated disposal value or zero given as residual value.

- (2) Intangible fixed assets

Software: Software costs are amortized on a straight-line basis over the estimated useful lives (5 years) in the company.

3. Accounting for allowance

- (1) Allowance for bad debts: To provide against the loss of bad debts, allowance for normal debt is estimated on the basis of reasonable criterion, whereas the estimated calculation of allowance for specified bad debts is treated individually as the amount that is likely to be recovered.
- (2) Allowance for residual value: A projected loss is used to provide against the risk of realizing loss on residual value.
- (3) Allowance for sales incentive: To provide for cost of sales incentives in relation to installment transactions, etc. in this fiscal year, the estimated payment amount based on contracts is used.
- (4) Bonus allowance: Allowance for bonuses is provided based upon the estimated amount of bonus payments to employees in the following fiscal year, which is attributable to this fiscal year.
- (5) Retirement reserve allowance: A retirement allowance is provided based upon the estimated present value of the retirement benefit obligation as at year-end. Actuarial gains and losses are amortized over the employees' average residual number of years of service on a straight-line basis, effective in the following fiscal year.
- (6) Retirement reserve allowance for directors: Retirement reserve allowance for directors is provided based upon the estimated present value of the retirement benefit obligation as at year-end.
- (7) Provision for point card certificates: In relation to point card certificates which were granted but not used in this fiscal year, the amount estimated to be used in the future is allocated in consideration of the past actual amount.

4. Recognition of revenue and expense

- (1) Revenue recognition of loan interests: Revenues are recognized on an accrual basis.
- (2) Revenue recognition regarding finance lease transactions: Accrued interest is allocated to each period, without sales amount.

5. Hedge accounting

Deferral hedge accounting is applied.

6. Accounting for consumption tax and local consumption tax

Consumption tax and local consumption tax are not included in the balances of the relevant accounts in the accompanying income statement. In addition, non-deductible consumption taxes and others are recognized as current expenses.

However, non-deductible consumption taxes paid on certain asset transactions are deferred as

prepaid expenses and amortized over a 5 year period on a straight-line basis under the Corporation Tax Act.

Notes to the balance sheet

1. Assets offered as security and corresponding obligation
 - (1) Assets offered as security

Installment accounts receivable	125,358,842 thousand yen
Advance payments	7,345,218 thousand yen
Long-term guarantee money deposited	1,032,000 thousand yen
 - (2) Obligation corresponding to assets offered as security

Payable under fluidity installment accounts receivable	48,377,750 thousand yen
Long-term payable under fluidity installment accounts receivable	56,078,378 thousand yen
2. Accumulated depreciation on tangible fixed assets 870,825 thousand yen
3. Monetary claims and liabilities related to affiliated companies

Short-term monetary claims	57,432 thousand yen
Long-term monetary claims	350,596 thousand yen
4. Fractional amounts of less than 1,000 yen have been discarded.

Notes to the income statement

1. Transactions with affiliated companies

Operating revenues and others	24,095 thousand yen
Selling, general and administrative expenses	30,015 thousand yen
2. Fractional amounts of less than 1,000 yen have been discarded.

Notes to the statement of changes in equity

1. Number of issued shares as of the end of this fiscal year

Common stock	20,200 shares
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2. Fractional amounts of less than 1,000 yen have been discarded.

Notes on deferred tax accounting

Deferred tax assets are attributed mainly to disallowed liabilities such as allowance for bad debts, allowance for residual value, allowance for sales incentive, prepaid expenses and excess depreciation amount.

Notes on changes in presentation

Reflects the changes in presentation due to early application of Partial Amendments to Accounting Standard for Tax Effect Accounting (ASBJ Statement No.28).

As a result of the application, Deferred tax assets is classified into Investments and other assets and Deferred tax liabilities is classified into Long-term liabilities.

Notes on financial instruments

1. Financial instrument disclosure

(1) Financial instrument policies

Our financial assets include receivables in relation to installment, lease, and financial transactions. We raise funds through indirect financing such as bank borrowings, as well as direct financing including issuance of bonds and commercial papers, and liquidation of debts.

To reduce credit risks resulting from breach of contract by customers, in accordance with our credit management rules, we regularly oversee due dates and balances by individual customer, and keep abreast of their credit status.

The Company has also conducted ALM (asset-liability management) in order to appropriately control interest-rate risks caused by mismatch of interest rate types and contract period of asset management and financing. We carry out derivatives trading only for the purpose of hedging interest-rate risks, and do not conduct speculative dealing to seek short-term profits.

While striving to ensure liquidity by diversifying financing instruments, we also manage financing-related liquidity risks according to our liquidity risk management rules.

(2) Supplementary notes on fair value of financial instruments

The fair values of financial instruments are based on market prices or rational calculations in the absence of such prices. Since those prices are calculated on certain assumptions, the adoption of different assumptions may result in price fluctuations. The contract amounts of derivatives trading stated in “2. Disclosure about fair value of financial instruments” do not reflect market risks of such trading.

2. Disclosure about fair value of financial instruments

The balance sheet and fair values, and the differences between them, as of December 31, 2018 were as follows. However, financial instruments of which fair value is extremely difficult to determine are not included (see Note 2).

(JPY in thousands)

	Balance sheet value	Fair value	Differences
(1) Cash on hand and in banks	4,572,369	4,572,369	—
(2) Accounts receivable – trade Allowance for bad debts (*1)	26,802,504 △156,832		
	26,645,672	26,645,672	—
(3) Installment of accounts receivable Deferred installment income Allowance for residual value (*1)	276,126,687 △12,069,915 △646,371		
	263,410,401	254,611,113	△8,799,288
(4) Lease investment assets Allowance for bad debts (*1)	28,902,886 △23,989		
	28,878,897	27,421,517	△1,457,380
(5) Short-term loans receivable Allowance for bad debts (*1)	14,860,196 △29,824		
	14,830,372	14,830,372	—
(6) Long-term loans receivable (*2) Allowance for bad debts (*1)	444,753 △7,403		
	437,350	490,138	52,788
Total assets	338,774,737	328,571,181	△10,203,556
(1) Accounts payable – trade	4,376,357	4,376,357	—
(2) Short-term borrowings	40,000,000	40,000,000	—
(3) Commercial paper (*3)	23,999,243	24,000,000	△757
(4) Liabilities from leasing business	292,430	278,502	13,928
(5) Bonds (*4)	32,000,000	32,105,797	△105,797
(6) Long-term borrowings (*5)	121,000,000	121,764,113	△764,113
(7) Long-term payable under fluidity installment accounts receivable (*6)	104,456,129	103,019,823	1,436,306
Total liabilities	326,124,159	325,544,592	579,567
Derivatives trading (*7)			
Derivatives trading that hedge accounting is applied to	(25,196)	(25,196)	—
Total derivatives trading	(25,196)	(25,196)	—

(*1) Allowances for bad debts or residual value respectively corresponding to accounts

receivable-trade, installment accounts receivable, lease investment assets, short-term loans receivable, and long-term loans receivable have been deducted.

(*2) Long-term loans receivable include long-term loans to be repaid within one year.

(*3) Discount fee has been deducted in lieu of the interest rate adjustment for the balance sheet amount on the commercial paper.

(*4) Bonds include bonds maturing within one year.

(*5) Long-term borrowings include borrowings for repayment within one year.

(*6) Long-term payable under fluidity installment accounts receivable include payable under fluidity installment accounts receivable.

(*7) The net amounts of receivables and payables caused by derivatives trading have been indicated. Total debts are shown in parentheses.

Note 1) Methodology for calculating fair values of financial instruments, and matters concerning derivatives trading

Assets

(1) Cash on hand and in banks, (2) Accounts receivable-trade, and (5) Short-term loans receivable

Due to the short maturities of these instruments, the carrying amount approximates fair value.

(3) Installment accounts receivable, (4) Lease investment assets, and (6) Long-term loans receivable

As these assets are subject to fixed interest rates, fair value is calculated by discounting the total amount of principal and interest using an interest rate assumed if conducting a similar new transaction with respect to each segment based on the type of receivable, the internal rating, and the period.

Liabilities

(1) Accounts payable-trade, and (2) Short-term borrowings

Due to the short maturities of these instruments, the carrying amount approximates fair value.

(3) Commercial paper

Due to the short maturities of these instruments, the face value approximates fair value.

(4) Liabilities from leasing business

The fair value of liabilities from leasing business is calculated by discounting the total amount of principal and interest using the interest rate assumed if conducting a similar new transaction.

(5) Bonds

The fair value of bonds is calculated by discounting the total amount of principal and interest using the interest rate assumed if issuing similar bonds.

(6) Long-term borrowings

Long-term borrowings subject to variable interest rates are recorded using book values as their fair values are deemed to approximate their book values since the variable interest rates reflect market interest rates over a short period and our credit status has not changed significantly since implementing these borrowings. The fair value of long-term borrowings subject to fixed rates is calculated by discounting the total amount of principal and interest of the long-term borrowing classified by a certain period using the interest rate assumed in case of similar borrowings.

(7) Long-term payable under fluidity installment accounts receivable

The fair value of long-term payable under fluidity installment accounts receivable is calculated by discounting the total amount of principal and interest of the long-term payable under fluidity installment accounts receivable classified by a certain period using the interest rate assumed if conducting similar liquidation of claims.

Derivatives trading

Derivatives trading that hedge accounting is applied to

When hedge accounting is applied to derivatives trading, the contract amount at the end of this fiscal year or the amount equivalent to principal stipulated in the contract by methodology for hedge accounting is as follows:

(a) Matters concerning interest rates

(JPY in thousands)

Methodology for hedge accounting	Kind of derivatives trading	Major hedged items	Contract amount, etc.		Fair value (*)
				Over 1 year	
Principal accounting method	Interest-rate swap agreement Payment of fixed interest / Reception of variable interest	Short-term borrowings	24,000,000	10,000,000	(25,196)
		Bonds Long-term borrowings			
Total			24,000,000	10,000,000	(25,196)

(*) Fair values are calculated based primarily on discounted cash flow.

Note 2) Financial instruments for which fair value is extremely difficult to determine

1. As unlisted stocks of affiliated companies (20,000 thousand yen posted in the balance sheet) do not have market prices, and their future cash flow cannot be estimated, the fair value is extremely difficult to determine. Therefore, those stocks are not included in notes on fair value.
2. Deposits received for guarantees (2,709,602 thousand yen posted in the balance sheet) are not included in notes on fair value. This is because future cash flow cannot be estimated as it is difficult to identify the time to return the deposits including guarantee money deposited from business partners and deposits for real estate. Consequently, the fair value is extremely difficult to determine.

Notes on investment and rental properties

1. Description of investment and rental properties

The Company has multi-tenant buildings and office buildings for rent (including land) in Tokyo and other areas.

2. Fair value of investment and rental properties

(JPY in thousands)

Balance sheet value			Year-end fair value
Beginning balance	Changes during the period	Year-end balance	
1,060,509	△16,391	1,044,118	1,059,309

Note 1) Balance sheet values are obtained by deducting the accumulated amount of depreciation costs from acquisition costs.

Note 2) Fair value at the end of this fiscal year is calculated by the Company, based mainly on "Real Estate Appraisal Standards" (including adjusted amounts with indicators, etc.)

Notes on related-party transactions

(JPY in thousands)

Relation	Name	Share-holding (-held) ratio	Relationship	Transaction	Amount (*5)	Account	Year-end balance
Parent	Volkswagen Financial Services AG	Share held Indirect 100%	• Guarantee on issue of commercial paper and bonds	Liabilities guaranteed (*1)	55,999,243	—	—
				Guarantee fee expense (*1)	30,015	—	—
Subsidiary of parent	Volkswagen Group Japan KK	NA	• Subvention income related to loans • Purchase receivable	Subvention income (*2)	1,287,148	Accounts receivable-other	113,664
				Purchased receivable (*2)	145,564,144	Accounts payable-trade	579,449
				Handling Charge of purchased receivable (*2)	79,201	Accounts receivable-other	5,042
Subsidiary of parent	Audi Japan KK	NA	• Subvention income related to loans • Purchase receivable	Subvention income (*2)	2,059,518	Accounts receivable-other	183,954
				Purchased receivable (*2)	121,870,546	Accounts payable-trade	1,541,890
				Handling charge of purchased receivable (*2)	105,254	Accounts receivable-other	4,895
Subsidiary of parent	Volkswagen Japan Sales KK	NA	• Leasing income	Purchase of cars (*3)	167,768	Accounts payable-trade	0
Subsidiary of parent	Audi Japan Sales KK	NA	• Leasing income • Funding loan • Concurrent board member	Purchase of cars (*3)	2,056,386	Accounts payable-trade	11,474
				Funding Loan receivable (*4)	5,438,861	Short-term loans receivable	5,567,569
				Loans collected	5,624,734		
				Loan interest income (*4)	7,103	Accrued income	197

Terms and conditions, and policies on settling conditions

(*1) Guarantee rates are settled after negotiating on the rates presented by Volkswagen Financial Services AG.

(*2) Conditions of subvention and receivables related to loans are determined after consideration of general market rates and individual negotiation.

(*3) Conditions of lease transactions are determined by comparison with general transaction conditions, taking general market rates into consideration.

(*4) Market interest rates are taken into consideration when deciding loan and borrowing rates.

(*5) The transaction amount in the above disclosure does not include consumption tax. The final balance includes consumption tax.

Per share data

Equity per share	955,063.94yen
Net income per share	114,025.03yen

Supplementary Schedules in relation to Financial Statements

(The 29th fiscal year from January 1, 2018 to December 31, 2018)

VOLKSWAGEN FINANCIAL SERVICES JAPAN LTD.

1. Details of tangible fixed assets and intangible fixed assets

(JPY in thousands)

Account item	Asset	Beginning book value	Increase during the period	Decrease during the period	Amount written off during the period	Year-end book value	Accumulated depreciation	Year-end acquisition cost
Tangible fixed assets	Buildings	194,065	—	—	14,361	179,703	299,819	479,522
	Building equipment	100,042	265	640	11,831	87,835	180,934	268,770
	Structures	8,144	—	—	974	7,170	37,126	44,297
	Machinery and equipment	10,876	—	—	3,507	7,369	40,630	48,000
	Vehicles and cars	93,147	23,757	11,897	31,686	73,319	39,125	112,444
	Furniture, fixtures and tools	134,091	41,520	—	38,617	136,993	273,188	410,181
	Land	845,862	—	—	—	845,862	—	845,862
	Total	1,386,230	65,542	12,538	100,980	1,338,254	870,825	2,209,079
Intangible fixed assets	Software	610,855	595,629	197,266	206,581	802,637	/	
	Telephone rights	0	—	—	—	0		
	Total	610,855	595,629	197,266	206,581	802,637		

(Note 1) Increase in the amount within the fiscal year on software was mainly due to the development of the dealer support system.

(Note 2) Decrease in the amount within the fiscal year on software was mainly due to the disposal of the project cost for the successor model selection of core systems (AS400).

2. Details of allowances

(JPY in thousands)

Account item	Beginning balance	Increase during the period	Decrease during the period		Year-end balance
			For intended use	Others	
Allowance for bad debts	307,508	218,050	—	307,508	218,050
Allowance for residual value	595,226	646,371	—	595,226	646,371
Allowance for sales incentive	974,175	972,138	974,175	—	972,138
Bonus allowance	114,717	128,734	114,717	—	128,734
Provision for point card certificates	1,122	990	1,122	—	990
Retirement reserve allowance	308,350	52,714	67,953	—	293,111
Retirement reserve allowance for directors	118,286	7,222	—	—	125,508

Note: The decrease (others) in allowance for bad debts and allowance for residual value during the period is caused by reversing the closing entry for the allowance.

3. Details of selling, general and administrative expenses

(JPY in thousands)

Item	Amount	Note
Sales promotion expense	192,122	
Payroll expense	1,123,946	
Traveling expense	102,102	
Guarantee cost	1,931,900	
Outsourcing expense	593,255	
Commission expense	22,503	
Rent expense	275,819	
Depreciation cost	317,276	
Costs regarding EDP	131,925	
Communication cost	159,897	
Convention expense	30,736	
Printing expense	5,825	
Books training expense	49,243	
Taxes other than income taxes	121,075	
Provision of allowance for residual value	51,145	
Other SG&A expenses	116,440	
Total	5,225,214	