

(English Translation)

Audit Report with Financial Report

(The 30th fiscal year from January 1, 2019 to December 31, 2019)

VOLKSWAGEN FINANCIAL SERVICES JAPAN LTD.

Independent Auditor's Report
(English Translation*)

February 26, 2020

To Mr. Zhong Zhong
Auditor
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 30th fiscal year from January 1, 2019 to December 31, 2019.

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 30th fiscal year from January 1, 2019 to December 31, 2019)

VOLKSWAGEN FINANCIAL SERVICES JAPAN LTD.

Balance Sheet

(As of December 31, 2019)

(JPY in thousands)

Account item	Amount	Account item	Amount
Assets		Liabilities	
Current assets	379,235,612	Current liabilities	160,172,219
Cash on hand and in banks	2,167,839	Accounts payable - trade	2,793,463
Accounts receivable - trade	27,455,846	Short-term borrowings	55,000,000
Installment accounts receivable	291,202,954	Commercial papers	29,998,187
Lease investment assets	32,089,887	Bonds payable within one year	11,000,000
Short-term loans receivable	17,734,088	Payable under fluidity installment accounts receivable	44,579,208
Advance payments	7,818,234	Liabilities from leasing business	300,942
Prepaid expenses	54,443	Accounts payable - other	346,537
Accounts receivable - other	1,554,347	Accrued expenses	912,417
Others	111,964	Income taxes payable	588,820
Allowance for bad debts	188,817	Advances received	1,184,988
Allowance for residual value	765,176	Deposits payable	424,016
Fixed assets	5,330,466	Deferred installment income	12,770,570
Tangible fixed assets	1,635,009	Bonus allowance	115,137
Buildings	167,655	Others	157,928
Building equipment	80,515	Long-term liabilities	202,076,129
Structures	6,391	Bonds	10,598,832
Machinery and equipment	3,861	Long-term borrowings	115,000,000
Vehicles and cars	82,247	Long-term payable under fluidity installment accounts receivable	73,071,299
Furniture, fixtures and tools	97,982	Deposits received for guarantees	2,742,844
Land	845,862	Retirement reserve allowance	311,446
Construction in progress	350,492	Retirement reserve allowance for directors	132,770
Intangible fixed assets	903,121	Asset retirement obligations	140,047
Software	903,121	Others	78,889
Telephone rights	0	Total liabilities	362,248,349
Investments and other assets	2,792,335	Equity	
Stocks of affiliated companies	20,000	Shareholders' equity	22,370,485
Long-term loans receivable	368,889	Capital stock	1,010,000
Long-term guarantee money deposited	1,230,094	Earned surplus	21,360,485
Deferred tax assets	1,175,060	Legal reserve	252,500
Allowance for bad debts	1,708	Retained earnings and others	21,107,985
		Retained earnings carried forward	21,107,985
		Valuation and translation adjustments	52,755
		Deferred gains and losses on hedges	52,755
		Total equity	22,317,729
Total assets	384,566,078	Total liabilities & equity	384,566,078

Income Statement

(from January 1, 2019 to December 31, 2019)

(JPY in thousands)

Account item	Amount	
Operating revenues		
Retail financing loan income	8,702,121	
Dealer financing income	322,806	
Finance leasing income	603,533	
Real estate rental income	208,861	
Credit card commission income	6,684	
Insurance commission income	813,501	
Others	281,767	10,939,276
Operating expenses		
Interest expenses	818,138	
Interest expenses (bond)	77,914	
Selling, general and administrative expenses	5,476,418	6,372,470
Operating income		4,566,805
Non-operating income		
Interest income	126	
Reversal of allowance for bad debts	27,524	27,651
Ordinary income		4,594,456
Extraordinary gains		
Gains from sales of fixed assets	7,314	7,314
Extraordinary loss		
Losses from disposing of fixed assets	81,188	
Losses from sales of fixed assets	3,237	84,425
Net income before taxes		4,517,346
Income taxes-current	1,067,270	
Income taxes-deferred	389,362	1,456,633
Net income		3,060,712

Statement of Changes in Equity

(from January 1, 2019 to December 31, 2019)

(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	18,047,272	18,299,772	19,309,772	17,481	19,292,291
Changes of items during the period							
Net income			3,060,712	3,060,712	3,060,712		3,060,712
Net changes of items other than shareholders' equity						△ 35,274	△ 35,274
Total changes of items during the period			3,060,712	3,060,712	3,060,712	35,274	3,025,437
Ending balance	1,010,000	252,500	21,107,985	21,360,485	22,370,485	52,755	22,317,729

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: The expected payment based on the contract was recorded in preparation for expenditures for sales incentives in regards to the installment transaction and the payout has been completed for this term in accordance with the abolition of the sales incentive payment system for this allowance. Therefore, no allowance for sales incentives has been recorded from this term.
- (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. As for the past service cost, collective expenses are processed in the year in which they occur.
- (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.

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.

Notes to the balance sheet

1. Assets offered as security and corresponding obligation

(1) Assets offered as security

Installment accounts receivable	141,009,784 thousand yen
Advance payments	7,818,234 thousand yen
Long-term guarantee money deposited	1,002,000 thousand yen

(2) Obligation corresponding to assets offered as security

Payable under fluidity installment accounts receivable	44,579,208 thousand yen
Long-term payable under fluidity installment accounts receivable	73,071,299 thousand yen

2. Accumulated depreciation on tangible fixed assets 845,308 thousand yen

3. Monetary claims and liabilities related to affiliated companies

Short-term monetary claims	57,243 thousand yen
Long-term monetary claims	295,744 thousand yen
Short-term liabilities	126,734 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	20,848 thousand yen
Selling, general and administrative expenses	58,056 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, prepaid expenses and excess depreciation amount.

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, 2019 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	2,167,839	2,167,839	—
(2) Accounts receivable – trade Allowance for bad debts (*1)	27,455,846 △136,683		
	27,319,163	27,319,163	—
(3) Installment of accounts receivable Deferred installment income Allowance for residual value (*1)	291,202,954 △12,770,570 △765,176		
	277,667,208	268,819,827	△8,847,381
(4) Lease investment assets Allowance for bad debts (*1)	32,089,887 △15,160		
	32,074,727	30,377,419	△1,697,308
(5) Short-term loans receivable Allowance for bad debts (*1)	17,734,088 △36,973		
	17,697,115	17,697,115	—
(6) Long-term loans receivable (*2) Allowance for bad debts (*1)	368,889 △1,708		
	367,181	417,234	50,053
Total assets	357,293,233	346,798,597	△10,494,636
(1) Accounts payable – trade	2,793,463	2,793,463	—
(2) Short-term borrowings	31,000,000	31,000,000	—
(3) Commercial paper (*3)	29,998,187	30,000,000	△1,813
(4) Liabilities from leasing business	300,942	294,039	6,903
(5) Bonds (*4)	21,598,832	21,629,521	△30,689
(6) Long-term borrowings (*5)	139,000,000	139,273,555	△273,555
(7) Long-term payable under fluidity installment accounts receivable (*6)	117,650,507	117,429,460	221,047
Total liabilities	342,341,931	342,420,038	△78,107
Derivatives trading (*7)			
Derivatives trading that hedge accounting is applied to	△76,039	△76,039	—
Total derivatives trading	△76,039	△76,039	—

(*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 negative.

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	14,000,000	△76,039
		Bonds Long-term borrowings			
Total			24,000,000	14,000,000	△76,039

(*) 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 (2,742,844 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	
1,044,118	△18,920	1,025,198	1,297,083

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)	51,597,020	—	—
				Guarantee fee expense (*1)	22,855	—	—
Subsidiary of parent	Volkswagen Group Japan KK	NA	• Subvention income related to loans • Purchase receivable	Subvention income (*2)	1,298,775	Accounts receivable-other	119,673
				Purchased receivable (*2)	135,657,869	Accounts payable-trade	649,446
				Handling Charge of purchased receivable (*2)	75,039	Accounts receivable-other	3,814
Subsidiary of parent	Audi Japan KK	NA	• Subvention income related to loans • Purchase receivable	Subvention income (*2)	2,077,905	Accounts receivable-other	191,436
				Purchased receivable (*2)	115,099,816	Accounts payable-Trade	292,993
				Handling charge of purchased receivable (*2)	115,475	Accounts receivable-other	5,135
Subsidiary of parent	Volkswagen Japan Sales KK	NA	• Leasing income	Purchase of cars (*3)	221,245	Accounts payable-trade	15,103
Subsidiary of parent	Audi Japan Sales KK	NA	• Leasing income • Funding loan	Purchase of cars (*3)	2,123,977	Accounts payable-trade	36,072
				Funding Loan receivable (*4)	5,081,583	Short-term loans receivable	4,923,738
				Loans collected	5,725,414		
				Loan interest income (*4)	2,764	Accrued income	283

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.

Notes on Debt Guarantee

The following guarantees are provided for Lamborghini purchased receivables.

The maximum amounts of debt guarantees are as follows.

KK RPM	581,308 thousand yen
KK Queen Auto	952,389 thousand yen
Mitsuoka Motor Co., Ltd.	1,355,751 thousand yen
Cornes Motors KK	1,769,166 thousand yen
Bolognese KK	1,930,000 thousand yen

Per share data

Equity per share	1,104,838.09 yen
Net income per share	151,520.42 yen

Supplementary Schedules in relation to Financial Statements

(The 30th fiscal year from January 1, 2019 to December 31, 2019)

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	179,703	—	—	12,047	167,655	311,866	479,522
	Building equipment	87,835	3,738	—	11,058	80,515	191,992	272,508
	Structures	7,170	—	—	778	6,391	37,905	44,297
	Machinery and equipment	7,369	—	—	3,507	3,861	44,138	48,000
	Vehicles and cars	73,319	71,018	29,735	32,355	82,247	39,133	121,381
	Furniture, fixtures and tools	136,993	23,619	24,342	38,288	97,982	220,271	318,253
	Land	845,862	—	—	—	845,862	—	845,862
	Construction in progress	—	350,492	—	—	350,492	—	350,492
	Total	1,338,254	448,867	54,077	98,036	1,635,009	845,308	2,480,318
Intangible fixed assets	Software	802,637	352,504	—	252,021	903,121	/	
	Telephone rights	0	—	—	—	0		
	Total	802,637	352,504	—	252,021	903,121		

(Note 1) Increase in the amount within the fiscal year on software was mainly due to the development of the dealer support system and BI tool for our own use.

(Note 2) Increase in the amount within the fiscal year on construction in progress was due to the construction cost for a new outlet to be rented.

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	218,050	190,525	—	218,050	190,525
Allowance for residual value	646,371	765,176	—	646,371	765,176
Allowance for sales incentive	972,138	—	972,138	—	—
Bonus allowance	128,734	115,137	119,819	8,914	115,137
Retirement reserve allowance	293,111	54,246	35,912	—	311,446
Retirement reserve allowance for directors	125,508	7,261	—	—	132,770

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	245,107	
Payroll expense	1,046,737	
Traveling expense	94,631	
Guarantee cost	2,011,597	
Outsourcing expense	578,107	
Commission expense	15,859	
Rent expense	288,812	
Depreciation cost	360,465	
Costs regarding EDP	218,882	
Communication cost	180,921	
Convention expense	22,054	
Printing expense	4,212	
Books training expense	37,354	
Taxes other than income taxes	118,421	
Provision of allowance for residual value	118,804	
Other SG&A expenses	134,447	
Total	5,476,418	