

**VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL
MITIGATION TRUST FOR STATE BENEFICIARIES,
PUERTO RICO, AND THE DISTRICT OF COLUMBIA**

**Financial Statements
December 31, 2017**

VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL MITIGATION TRUST FOR STATE
BENEFICIARIES, PUERTO RICO, AND THE DISTRICT OF COLUMBIA

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Independent Auditor's Report

To the Trustee
Volkswagen Diesel Emissions Environmental Mitigation Trust for
State Beneficiaries, Puerto Rico, and the District of Columbia

We have audited the accompanying statement of net assets of Volkswagen Environmental Mitigation Trust for State Beneficiaries, Puerto Rico, and the District of Columbia (the "Trust") as of December 31, 2017 and the related changes in net assets and cash flows for the period October 2, 2017 (inception) through December 31, 2017, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit 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 the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, 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 in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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 referred to above present fairly, in all material respects, the financial position of Volkswagen Diesel Emissions Environmental Mitigation Trust for State Beneficiaries, Puerto Rico, and the District of Columbia as of December 31, 2017 and the changes in its net assets and its cash flows for the period from October 2, 2017 through December 31, 2017 in conformity with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Plante & Moran, PLLC".

March 26, 2018

**VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL MITIGATION TRUST FOR STATE
BENEFICIARIES, PUERTO RICO, AND THE DISTRICT OF COLUMBIA**

Statement of Net Assets
(Dollars in thousands)

December 31, 2017

ASSETS

Current Assets

Cash and Cash Equivalents (Note 3)	\$	12,018
Marketable Securities (Note 3)		1,977,543
Funding Receivable (Note 5)		881,940
Other Current Assets		292

Total Current Assets		2,871,793
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Fixed Assets - net		172
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Prepaid Expenses		2,108
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TOTAL ASSETS		2,874,073
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LIABILITIES

Current Liabilities

Accounts Payable and Other Current Liabilities		211
Income Tax Payable (Note 6)		1,264
Deferred Tax Liabilities - net (Note 6)		1,157

Total Current Liabilities		2,632
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Non-Current Liabilities

Deferred Tax Liabilities (Note 6)		837
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Total Non-Current Liabilities		837
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TOTAL LIABILITIES		3,469
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NET ASSETS	\$	2,870,604
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See Accompanying Notes to Financial Statements

**VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL MITIGATION TRUST FOR STATE
BENEFICIARIES, PUERTO RICO, AND THE DISTRICT OF COLUMBIA**

Statement of Changes in Net Assets

(Dollars in thousands)

	For the period October 2, 2017 through December 31, 2017
Net Assets, beginning of period	\$ -
Increase (decrease) in Net Assets	
Trust Funding	2,865,636
Investment Income	9,193
Trust Expenses	(967)
Income Taxes	(3,258)
Net Increase in Net Assets	<u>2,870,604</u>
Net Assets, end of period	<u>\$ 2,870,604</u>

See Accompanying Notes to Financial Statements

**VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL MITIGATION TRUST FOR STATE
BENEFICIARIES, PUERTO RICO, AND THE DISTRICT OF COLUMBIA**

Statement of Cash Flows

(Dollars in thousands)

	For the period October 2, 2017 through December 31, 2017
Cash Flows from (used in) Operating Activities	
Changes in Net Assets	\$ 2,870,604
Adjustments to Reconcile Change in Net Assets to Net Cash used in Operating Activities	
Depreciation and Amortization	2
Changes in Operating Assets and Liabilities:	
Funding Receivable	(881,940)
Interest Income Receivable	(4)
Marketable Securities Fair Value Adjustment	(2,863)
Prepaid Expenses	(2,378)
Income Tax Liabilities	1,264
Deferred Tax Liabilities - net	1,994
Accounts Payable and Other Current Liabilities	211
Net Cash Flows from (used in) Operating Activities	<hr/> 1,986,890
Cash flows from (used in) investing activities	
Purchase of Fixed Assets	(174)
Purchase of Marketable Securities	(3,023,120)
Proceeds from Sales and Maturities of Marketable Securities	1,048,422
Net Cash Flows from (used in) Investing Activities	<hr/> (1,974,872)
Net Change in Cash	12,018
Cash and Cash Equivalents, beginning of period	-
Cash and Cash Equivalents, end of period	<hr/> \$ 12,018 <hr/>

**VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL MITIGATION TRUST FOR STATE
BENEFICIARIES, PUERTO RICO, AND THE DISTRICT OF COLUMBIA**

**Notes to Financial Statements
December 31, 2017**

Note 1 – Description of Trust

Establishment of Trust

Volkswagen Diesel Emissions Environmental Mitigation Trust for State Beneficiaries, Puerto Rico, and the District of Columbia (the “State Trust”) and Volkswagen Diesel Emissions Environmental Mitigation Trust for Indian Tribe Beneficiaries (the “Indian Tribe Trust”), collectively the “Trusts”, have been established by order of the United States District Court for the Northern District of California in accordance with a Partial Consent Decree on October 25, 2016 (“First Partial Consent Decree” or “2.0 Liter”) in re: Volkswagen “Clean Diesel” Marketing, Sales Practices, and Products Liability Litigation, MDL No. 2672 CRB (JSC) (Dkt. No. 2103-1), among Volkswagen AG, Audi AG, Volkswagen Group of America, Inc., and Volkswagen Group of America Chattanooga Operations, LLC (collectively, the “Settling Defendants”), the United States, and the State of California. In that case, the Court also entered a Second Partial Consent Decree (Dkt. No. 3228-1) on May 17, 2017 (the “Second Partial Consent Decree” or “3.0 Liter”), among the Settling Defendants, Dr. Ing. h.c. F. Porsche AG, and Porsche Cars North America, Inc. (collectively, the “Defendants”), the United States, and the State of California.

The Defendants and Wilmington Trust, N.A. (the “Trustee”) have entered into an Environmental Mitigation Trust Agreement for State Beneficiaries (hereinafter, the “State Trust Agreement”)—i.e., for the 50 States, Puerto Rico, and the District of Columbia—and established the environmental mitigation trust described therein (the “State Mitigation Trust” or “State Trust”). They have concurrently entered into a separate Environmental Mitigation Trust Agreement for Indian Tribe Beneficiaries (hereinafter, the “Indian Tribe Trust Agreement”)—i.e., for federally-recognized Indian Tribes—and established the environmental mitigation trust described in that agreement (“Indian Tribe Mitigation Trust” or “Indian Tribe Trust”).

The State Mitigation Trust and the Indian Tribe Mitigation Trust were both approved by Court Order on September 19, 2017 (the “Approval Order”) and final fully-executed versions were filed with the Court on October 2, 2017, establishing October 2, 2017 as the Effective Date for each Trust pursuant to the terms of the Approval Order (the “Effective Date”).

The Consent Decrees required the Defendants to establish the State Trust to fund environmental mitigation projects that reduce emissions of nitrogen oxides (NO_x) where the subject vehicles were, are, or will be operated (“Eligible Mitigation Actions”), and to pay for Trust Administration Costs as set forth in the State Trust Agreement.

The purpose of the State Trust is to expeditiously and efficiently fund Eligible Mitigation Actions to be proposed and administered by the State Beneficiaries subject to the requirements of the Consent Decrees and the terms of the States Trust Agreement and to provide funds for the administration and operations in accordance with the terms of the State Trust Agreement, as set forth therein. The goal of each Eligible Mitigation Action shall be to achieve reductions of NO_x emissions in the United States.

Funding of Trust

The State Mitigation Trust and the Indian Tribe Mitigation Trust are funded with Mitigation Trust Payments according to the terms of the Consent Decree: (1) 97.99% of the Mitigation Trust Payments from the First Partial Consent Decree (2.0 Liter) is allocated to the State Mitigation Trust and 2.01% to the Indian Tribe Mitigation Trust; and (2) 97.70% of the Mitigation Trust Payments from the Second Partial Consent Decree (3.0 Liter) is allocated to the State Mitigation Trust and 2.30% to the Indian Tribe Mitigation Trust.

**VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL MITIGATION TRUST FOR STATE
BENEFICIARIES, PUERTO RICO, AND THE DISTRICT OF COLUMBIA**

**Notes to Financial Statements
December 31, 2017**

Note 2 – Summary of significant Accounting and Reporting Policies

Basis of Presentation and Fiscal Year

The financial statements and accompanying notes have been prepared using the accrual basis of accounting in accordance with U.S. generally accepted accounting principles (U.S. GAAP).

The accompanying financial statements present the State Trust's changes in net assets from its effective date on October 2, 2017 to December 31, 2017. The Trust's normal fiscal period is a calendar year ended December 31.

Cash and Cash Equivalents

Cash and cash equivalents consist of amounts held in bank accounts or money market funds.

Marketable Securities

Marketable securities at December 31, 2017 consist of short term investments in U.S. Treasury bills. The State Trust has valued these securities at fair value.

Property and Equipment

Property and equipment including website development costs are stated at cost, less accumulated depreciation and amortization. Depreciation and amortization are calculated on a straight-line basis over estimated service lives of three to ten years.

Other Assets

Other assets consist principally of accrued investment income and prepaid expenses.

Accounts Payable and Other Liabilities

Accounts payable and other liabilities represent amounts due to professionals, other service providers and vendors for services rendered through the end of the period.

Income Taxes

The State Trust Agreement requires the Trustee to pursue a private letter ruling (the "PLR") that the State Trust will be treated as a qualified settlement fund ("QSF") pursuant to Treasury Regulation Section 468B and that all investment income earned on the Funds held by the State Trust will be excludible from gross income under Treasury Regulation Section 115. See Note 7 for additional information on federal income taxes.

The State Trust is not subject to state income taxes under current law. Accordingly, no current state income tax liabilities and assets are recorded.

The State Trust recognizes the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by the taxing authority, based on the technical merits of the position, review of available evidence and consultation with Trust professionals.

**VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL MITIGATION TRUST FOR STATE
BENEFICIARIES, PUERTO RICO, AND THE DISTRICT OF COLUMBIA**

**Notes to Financial Statements
December 31, 2017**

(Note 2 - Continued)

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities. These estimates are subject to known and unknown risks, uncertainties and other factors that could materially impact the amounts reported and disclosed in the financial statements and related footnotes. Significant estimates include estimated investment income expected to be received and fair value of marketable securities. Actual results could differ from those estimates.

Subsequent events

The State Trust evaluated events and transactions occurring between December 31, 2017 and March 26, 2018, which is the date that the financial statements were available to be issued, for disclosure and recognition purposes.

Note 3 – Cash and Cash Equivalents and Marketable Securities

As of December 31, 2017, cash and cash equivalents and U.S. treasury bills aggregated \$1,987 million and comprised of the following:

(in thousands)	
Cash	\$ 3,227
Money market	8,791
U.S. Treasury Bills	1,977,543
Total	<u>\$ 1,989,561</u>

Note 4 – Fair Value Measurement

Accounting standards require certain assets and liabilities be reported at fair value in the financial statements and provide a framework for establishing that fair value. The framework for determining fair value is based on a hierarchy that prioritizes the inputs and valuation techniques used to measure fair value. The State Trust's Cash Equivalents and Marketable Securities are presented as provided by this hierarchy.

Level 1—In general, fair values determined by Level 1 inputs use quoted prices in active markets for identical assets and liabilities that the State Trust has the ability to access.

Level 2—Fair values determined by Level 2 inputs use other inputs that are observable, either directly or indirectly. These Level 2 inputs include quoted prices for similar assets or liabilities in active markets, and other inputs such as interest rates and yield curves that are observable at commonly quoted intervals.

**VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL MITIGATION TRUST FOR STATE
BENEFICIARIES, PUERTO RICO, AND THE DISTRICT OF COLUMBIA**

**Notes to Financial Statements
December 31, 2017**

(Note 4 – Continued)

Level 3—Level 3 inputs are unobservable inputs, including inputs that are available in situations where there is little, if any, market activity for the related asset or liability. These Level 3 fair value measurements are based primarily on management’s own estimates using pricing models, discounted cash flow methodologies, or similar techniques taking into account the characteristics of the asset or liability. The State Trust had no assets or liabilities that are measured with Level 3 inputs at December 31, 2017.

In instances where inputs used to measure fair value fall into different levels in the above fair value hierarchy, fair value measurements in their entirety are categorized based on the lowest level input that is significant to the valuation. The State Trust’s assessment of the significance of particular inputs to these fair value measurements requires judgment and considers factors specific to each asset or liability.

The State Trust also holds other financial instruments not measured at fair value on a recurring basis, including funding receivable, accounts payable and other assets. The fair value of these assets and liabilities approximates the carrying amounts in the accompanying financial statements due to the short maturity of such instruments.

The following table presents information about the State Trust’s assets measured at fair value on a recurring basis at December 31, 2017 and the valuation techniques used by the State Trust to determine those fair values.

(in thousands)	December 31, 2017			
	Level 1	Level 2	Level 3	Total
Assets:				
Cash Equivalents:				
Money Market Funds	\$ 8,791	\$ -	\$ -	\$ 8,791
Marketable Securities:				
U.S. Treasury bills	-	1,977,543	-	1,977,543
Total	\$ 8,791	\$ 1,977,543	\$ -	\$ 1,986,334

The following are descriptions of the valuation methodologies used for assets measured at fair value.

- Due to their short-term liquid nature, the fair value of cash equivalents approximates carrying value.
- Marketable securities at December 31, 2017 consist of U.S. Treasury bills. Due to their short-term maturities, the fair value of U.S. Treasury bills approximates their principal amounts.

The State Trust’s policy is to recognize transfers between levels of the fair value hierarchy as of the actual date of the event of change in circumstances that caused the transfer. There were no such transfers during the period ended December 31, 2017.

VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL MITIGATION TRUST FOR STATE BENEFICIARIES, PUERTO RICO, AND THE DISTRICT OF COLUMBIA

**Notes to Financial Statements
December 31, 2017**

Note 5 – Funding Receivable

The Trustee allocates to the State Trust the following amounts: (1) 97.99% of the Mitigation Trust Payments from the First Partial Consent Decree (2.0 Liter); and (2) 97.70% of the Mitigation Trust Payments from the Second Partial Consent Decree (3.0 Liter). The total funding from both decrees is \$2,865 million with \$2,840 million allocated to the State Trust and \$25.4 million allocated to the State Trust Administration Costs.

The funding receivable at December 31, 2017 comprised of the following:

(in thousands)	December 31, 2017		
	2.0 Liter	3.0 Liter	Total Funding Allocation
State Trust Allocation	\$ 2,622,354	\$ 217,859	\$ 2,840,213
Funding Received	(1,748,236)	(217,859)	(1,966,095)
State Trust Allocation Receivable	874,118	-	874,118
State Trust Administration Cost	23,467	1,956	25,423
Funding Received	(15,645)	(1,956)	(17,601)
State Trust Administration Cost Receivable	7,822	-	7,822
Total Funding Receivable	<u>\$ 881,940</u>	<u>\$ -</u>	<u>\$ 881,940</u>

The Trustee expects the funding receivable to be fully funded before December 31, 2018.

Note 6 – Income Taxes

The State Mitigation Trust is intended to be a qualified settlement fund pursuant to section 468B of the Internal Revenue Code, 26 U.S.C. 468B, and related Treasury Regulations. The Trustee shall use its best efforts to submit, within six months after the Trust Effective Date, an application to obtain a Private Letter Ruling from the IRS that the State Trust will be treated as a qualified settlement fund and exempt from Federal Income Taxes. The State Trust has filed the PLR as described in Note 2. The PLR application is pending as of December 31, 2017.

The State Trust calculates taxable income in the same manner as a C corporation at a rate of 39.60% using trust income tax rates on its modified gross income. Modified gross income includes gross income pursuant to Internal Revenue Code Section 61, less administrative expenses, certain losses from the sale, exchange or worthlessness of property, and net operating losses.

As the States Trust is taxable for federal income tax purposes, a current income tax liability is recognized for estimated taxes payable for the year.

**VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL MITIGATION TRUST FOR STATE
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**Notes to Financial Statements
December 31, 2017**

(Note 6 – Continued)

The provision for income taxes consists of:

(in thousands)	For the Period October 2, 2017 through December 31, 2017	
Current	\$	1,264
Deferred		1,994
	\$	3,258

Deferred income taxes arise from temporary differences between tax basis of assets and liabilities and their reported amounts in the financial statement, which will result in taxable or deductible amounts in the future. Deferred tax assets are reviewed for recoverability and valuation allowances are provided as necessary.

The components of the State Trust's deferred assets and liabilities consist of:

(in thousands)	<u>December 31, 2017</u>	
Current Deferred Tax Assets		
Accounts Payable and Other Current Liabilities	\$	84
Total Current Deferred Tax Assets		84
Current Deferred Tax Liabilities		
Prepaid Expenses		105
Accrued Investment Income		1,136
Total Current Deferred Tax Liabilities		1,241
Non Current Deferred Tax Liabilities		
Prepaid Expenses		837
Total Non Current Deferred Tax Liabilities		837
Total Deferred Tax Liabilities - net	\$	1,994

**VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL MITIGATION TRUST FOR STATE
BENEFICIARIES, PUERTO RICO, AND THE DISTRICT OF COLUMBIA**

**Notes to Financial Statements
December 31, 2017**

Note 7 – Related Party Transactions

Pursuant to the First Partial Consent Decree, the Court appointed Wilmington Trust, N.A, as Trustee of the Environmental Mitigation Trust to administer the State Mitigation Trust. Wilmington Trust N.A. is acting in two separate and distinct roles: 1) as the Trustee of the State Mitigation Trust; and 2) as the Investment Manager of the Trust Asset. The fees and commissions charged by Wilmington Trust N.A. are consistent with the standard fees and commissions charged by Wilmington Trust N.A. to unrelated third parties in negotiated transactions.

The following tables are the fees and commissions due to Wilmington Trust N.A. as of December 31, 2017 and the fees and commissions charged by Wilmington Trust N.A. during the period October 2, 2017 through December 31, 2017:

(in thousands)	December 31, 2017
Liabilities	
Accrued Investment Management Fee	\$ 65
Total Liabilities	\$ 65

(in thousands)	For the Period October 2, 2017 through December 31, 2017
Expenses	
Trust Acceptance Fee	\$ 98
Trust Administration Fee	36
Trust Advanced Flat Fee	5
Trust Investment Management Fee	144
Total Expenses	\$ 283

Independent Auditor's Report on Supplemental Information

To the Trustee

Volkswagen Diesel Emissions Environmental Mitigation Trust for
State Beneficiaries, Puerto Rico, and the District of Columbia

We have audited the financial statements of Volkswagen Environmental Mitigation Trust for State Beneficiaries, Puerto Rico, and the District of Columbia (the "Trust") as of December 31, 2017 and for the period from October 2, 2017 through December 31, 2017 and have issued our report thereon dated March 26, 2018, which contained an unmodified opinion on those financial statements. Our audit was performed for the purpose of forming an opinion on the 2017 financial statements as a whole. The supplemental trust administration actual costs versus budget schedule is presented for the purpose of additional analysis rather than to present the financial position, changes in net assets, and cash flows of the Trust and is not a required part of the financial statements.

This supplemental information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the 2017 financial statements. The information has been subjected to the auditing procedures applied in the audit of the 2017 financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the 2017 financial statements as a whole.

Plante & Moran, PLLC

March 26, 2018

**VOLKSWAGEN DIESEL EMISSIONS ENVIRONMENTAL MITIGATION TRUST FOR STATE
BENEFICIARIES, PUERTO RICO, AND THE DISTRICT OF COLUMBIA**

**Supplemental Schedule
Trust Administration Costs Actual vs. Budget
For the Period October 2, 2017 through December 31, 2017**

(in thousands)	<u>Actual Accrual Basis</u>	<u>Budget</u>	<u>Variance</u>
Trust Administrator Costs	\$ 283	\$ 178	\$ 105
Trust Counsel	539	693	(154)
Trust Accountants	-	128	(128)
Tax Return Preparation	-	15	(15)
Trust Audit	-	60	(60)
Website Support	2	78	(76)
Intralinks	9	38	(29)
Insurance	60	2,409	(2,349)
Tax Counsel	74	115	(41)
Contingency Expenses	-	250	(250)
State Trust Total	<u>\$ 967</u>	<u>\$ 3,964</u>	<u>\$ (2,997)</u>