Harvest One Cannabis Inc.

Management's Discussion and Analysis

For the three and six months ended December 31, 2019

INTRODUCTION

This Management's Discussion and Analysis ("MD&A") should be read in conjunction with the unaudited condensed consolidated interim financial statements and related notes thereto of Harvest One Cannabis Inc. ("Harvest One" or "us" or "we" or "our" or the "Group" or the "Company") for the three and six months ended December 31, 2019 and the audited annual consolidated financial statements for the year ended June 30, 2019, which have been prepared in accordance with International Financial Reporting Standards ("IFRS"). All amounts are expressed in thousands of Canadian dollars, except for share and per share amounts, unless otherwise stated. This MD&A has been prepared as of March 2, 2019 and includes certain statements that may be deemed "forward-looking statements". Additional information relating to the Company, including the Company's Annual Information Form dated April 17, 2019, is available under the Company's profile at www.sedar.com.

FORWARD LOOKING STATEMENTS

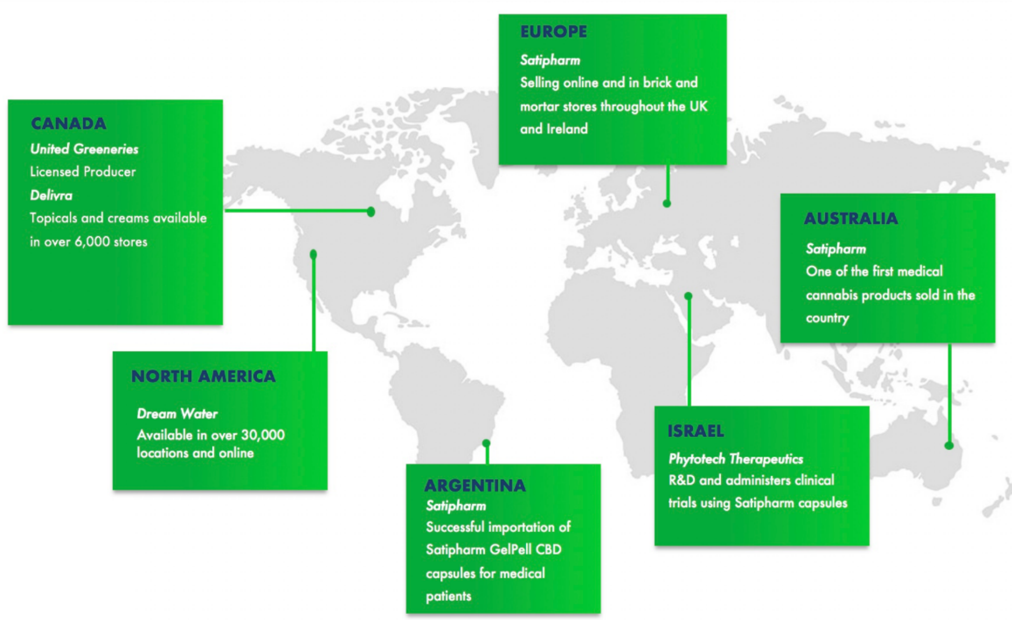
Certain statements contained in this MD&A constitute forward-looking statements and forward-looking information (collectively, "Forward-Looking Statements") and the Company cautions investors about important factors that could cause the Company's actual results to differ materially from those expressed, implied or projected in any Forward-Looking Statements included in this MD&A. Any statements that express, or involve discussions as to, expectations, beliefs, plans, objectives, assumptions or future events or performance (often, but not always, through the use of words or phrases such as "will likely result", "are expected to", "expects", "will continue", "is anticipated", "anticipates", "may", "could", "believes", "estimates", "intends", "plans", "forecast", "projection" and "outlook") are not historical facts and may be Forward-Looking Statements that involve projections, estimates, assumptions, known and unknown risks and uncertainties which could cause actual results or outcomes to differ materially from those expressed in such Forward-Looking Statements or otherwise be materially inaccurate. No assurance can be given that these expectations or assumptions will prove to be correct and such Forward-Looking Statements included in this MD&A should not be unduly relied upon. These Forward-Looking Statements speak only to management's beliefs and expectations as of the date of this MD&A and will be updated only as required by applicable securities laws. Accordingly, any such statements are qualified in their entirety by reference to the information discussed throughout this MD&A.

Certain of the Forward-Looking Statements relating to the medical and recreational cannabis industry contained within this MD&A are based on third-party information from publicly available government sources, market research and industry analysis. While the Company is not aware of any misstatement regarding any industry or government data presented herein, we have not independently verified any such third-party information.

The medical and recreational cannabis industry involves risks and uncertainties that may change based on various factors. The Company's Forward-Looking Statements are expressly qualified in their entirety by this cautionary statement. In particular, but without limiting the foregoing, disclosure in this MD&A under the heading "Business Overview" as well as statements regarding the Company's objectives, plans, goals, future operating results, economic performance and patient acquisition efforts may make reference to or involve Forward-Looking Statements. See the discussion under the heading "Risks and Uncertainties" for further details.

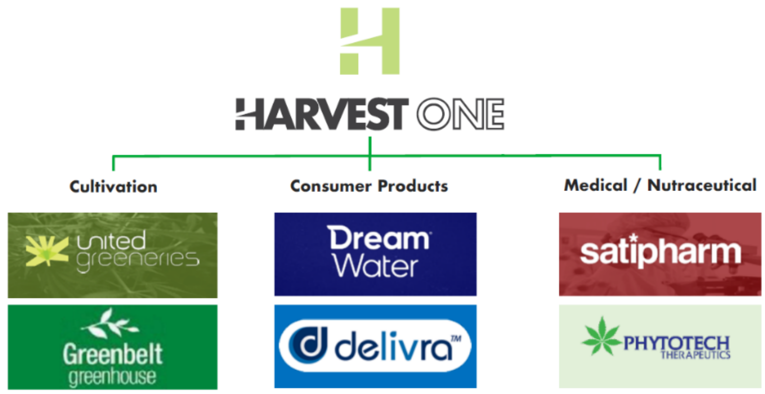
The Company cautions that the list and description of the Forward-Looking Statements, risks, assumptions and uncertainties set out above is not exhaustive.

BUSINESS OVERVIEW



Harvest One is a global consumer packaged goods company that develops and distributes premium heath, wellness, and self-care products to patients and consumers in regulated markets around the world with a specific focus on sleep, anxiety and pain. The Company is based in British Columbia ("BC"), Canada and its common shares (the "Common Shares") are listed on the TSX Venture Exchange ("TSX-V") under the symbol "HVT" and on the OTCQX® Best Market operated by OTC Market Group ("OTCQX") under the symbol "HRVOF".

Harvest One operates a global house of brands through its wholly-owned subsidiaries: United Greeneries Ltd. ("United Greeneries"), a Canadian licensed producer of cannabis and cannabis derivative products; Satipharm Limited ("Satipharm") and PhytoTech Therapeutics Ltd. ("PhytoTech"), both under the Group's medical and nutraceutical arm; and Dream Water Global ("Dream Water") and Delivra Corp. ("Delivra") the Group's consumer arm.



Cultivation

United Greeneries is licensed to produce and sell cannabis under the Cannabis Act (the "Act") in the medical and recreational markets. United Greeneries originally received its licence to cultivate medical cannabis under the *Access to Cannabis for Medical Purposes Regulations* (the "ACMPR") on June 28, 2016, and on October 13, 2017 received an amendment to its licence to allow for the sale of medical cannabis products to the public (the "UG Licence"). The UG Licence has been migrated to a valid, equivalent licence under the Act to allow for the sale of cannabis in the recreational market in addition to medical cannabis products. The UG License was further amended in September 2019 to allow for the sale of cannabis oil products. The UG Licence is registered to United Greeneries' Duncan facility located at 5250 Mission Road, Duncan, BC (the "Duncan Facility"). In October 2019, United Greeneries received a cultivation licence from Health Canada for Phase 1 of its new modular expansion facility located adjacent to the Duncan Facility (the "Mission Road Facility").

Greenbelt owns a 152,000 square foot greenhouse facility (the "Greenbelt Facility"). The Company's investment in Greenbelt has been identified as a non-core asset and, as such, the Company currently intends to divest its interest in Greenbelt.

Medical and Nutraceutical

Satipharm is an international medical and nutraceutical cannabis company focused on the delivery of cannabinoids through oral delivery technologies, currently servicing markets in the United Kingdom, Ireland, Australia, and Argentina, and expanding distribution into New Zealand, further into Europe, and elsewhere around the globe when and where legal. Satipharm holds the exclusive global marketing and distribution rights to the Gelpell® Microgel technology for all cannabinoids. In November 2019, Health Canada granted United Greeneries permission to import CBD Gelpell® capsules into Canada for research and development purposes.

PhytoTech develops cannabinoid-based drug products for a variety of clinical trials to service the medical market. PhytoTech was also responsible for administrating the successful clinical trials using Satipharm's proprietary CBD Gelpell® microsphere capsules ("CBD Gelpell® capsules").

Consumer

Dream Water focuses on sleep aids in a variety of formats and formulations. Dream Water manufactures and sells a 74 ml, 0-calorie, liquid sleep shot and a 3 gram sleep powder sachet to promote relaxation and support restful sleep.

Delivra manufactures and sells a range of natural topical creams for joint and muscle pain, nerve pain, varicose veins, and wound healing under the LivRelief™ brand.

Our Brands and Distribution

United Greeneries currently offers multiple SKUs through two consumer brands: (1) Royal High™, a premium cannabis brand featuring a full bud product, craft-grown, harvested, and hand selected by our team of cannabis experts; and (2) Captain's Choice™, a unique milled and blended product crafted to give the best possible experience for value. United Greeneries has supply agreements in place with five provinces: British Columbia, Alberta, Saskatchewan, Manitoba and Ontario. Royal High™ is available for purchase across all five provinces, and Captain's Choice™ is available to purchase through retail outlets across Alberta, Saskatchewan, and Manitoba. The Company continues to focus on establishing its brand within the ever-expanding recreational cannabis market.

Satipharm's current products are CBD only products, sold as CBD Gelpell® capsules and CBD oil. The CBD Gelpell® capsules products utilize cannabis extracts sourced from Europe and processed and manufactured in Luxembourg and Switzerland-based GMP-certified production facilities, respectively. Satipharm's CBD oil products are similarly GMP-certified and are sourced from the United States (the "US"). Satipharm currently sells its products in the United Kingdom, Ireland, Australia, and Argentina, with Satipharm-branded medical cannabis products also sold in Canada.

Dream Water currently has two distinct product lines: sleep and beauty. Each of the lines is carefully designed to offer a different experience for the consumer based on their lifestyle. Dream Water products are available in over 30,000 stores throughout the US and Canada. The Dream Water formula is adaptive and can be formulated into a number of delivery formats beyond liquids. Dream Water has received the NSF International Certified for Sport® designation which allows the Company to sell products to professional sport teams and athletes who undertake drug testing.

Delivra manufactures and sells an expanding line of natural topical pain relief creams with a proprietary transdermal delivery system platform under the LivRelief™ brand, for conditions such as joint and muscle pain, nerve pain, varicose veins, wound healing, and sports performance. LivRelief™ products are currently available in approximately 6,000 retail locations across Canada.

KEY FINANCIAL RESULTS

Select Financial Information	For the three months ended December 31 2019 $	2018 $	For the six months ended December 31 2019 $	2018 $
Net revenue	**1,768**	3,742	**5,832**	5,421
Gross profit	**66**	1,127	**1,331**	1,705
Expenses	**16,014**	4,355	**22,470**	10,750
Loss from operations	**(15,948)**	(3,228)	**(21,139)**	(9,045)
Net loss attributable to common shareholders	**(15,991)**	(3,332)	**(21,252)**	(9,127)
Net loss per share – basic and diluted	**(0.07)**	(0.02)	**(0.10)**	(0.05)
Weighted average number of Common Shares	**214,753,945**	177,629,038	**214,207,173**	175,625,245
Adjusted EBITDA[1]	**(4,993)**	(1,591)	**(8,413)**	(5,564)

(1) Defined as loss from operations before interest, taxes, depreciation and amortization adjusted for additional fair value items and other non-cash items, which is a non-GAAP measure discussed in the "Adjusted EBITDA" section.

Select Statements of Financial Position Information	December 31 2019 $	June 30 2019 $
Cash and cash equivalents	**780**	20,301
Cannabis inventories and biological assets	**9,753**	6,419
Non-cannabis inventories	**7,360**	3,521
Non-current assets	**79,213**	66,907
Equity	**94,944**	93,135

SIGNIFICANT AND RECENT DEVELOPMENTS

Corporate

a) Review of Strategic Alternatives

In February 2020, the Company's Board of Directors initiated a process to evaluate a range of strategic alternatives available to the Company (the "Strategic Review"). AltaCorp Capital Inc. and Mackie Research Capital Corporation have been appointed to act as exclusive financial advisors to the Company with respect to the Strategic Review. The Board of Directors has appointed a special committee of independent directors (the "Special Committee") to oversee the Strategic Review. The Company has not established a definitive timeline to complete the Strategic Review and no decisions related to any strategic alternatives have been reached at this time. There is no assurance that any strategic transaction or transactions will result from the Strategic Review.

b) Strategic Plan

In November 2019, management of the Company announced a strategic plan (the "Plan"). Key elements of the Plan include: (i) repurposing the Lucky Lake Facility to focus on the Company's strengths of brand development and distribution, including the development and manufacturing of infused products and strengthening its consumer packaged goods division; (ii) reducing overhead expenses by initiating a reduction in workforce by approximately 20% across all divisions, along with other operating cost reduction initiatives, resulting in cost savings of approximately 30% on an annualized basis; and (iii) reviewing non-core assets in order to reduce the Company's overall exposure to pure cultivation assets and redirect its efforts and resources on brand development, production, and distribution.

Financing

a) Loan Agreement with MMJ Group Holdings Limited ("MMJ")

In January 2020, Harvest One entered into a secured loan agreement with MMJ for a loan in the principal amount of $2,000 (the "Loan"), issued on January 13, 2020 (the "Issue Date"). The Loan bears interest at a rate of 15% per annum and the principal and accrued interest on the Loan is payable in arrears within 60 days of the Issue Date, subject to certain exceptions. Harvest One granted MMJ a security interest in all current and subsequently acquired property of the Company and certain property of its subsidiaries. The Company used the proceeds from the Loan for general corporate purposes including the development and rollout of the Company's Cannabis 2.0 product line. MMJ is the largest shareholder of the Company, owning approximately 25.8% of the Company's issued and outstanding common shares.

b) Sale of Non-Core Interest in Burb and Lillooet Property

In February 2020, Harvest One successfully divested its 19.99% interest in Burb Cannabis Corp. ("Burb"), a private cannabis retailer based in British Columbia for cash proceeds of $1,513, as well as the forgiveness of a shareholder loan to Burb with a face value of $250. In addition, Burb and Harvest One of concurrently agreed to terminate warrants in the capital of Burb held by Harvest One and Harvest One's option to purchase a majority equity interest in Burb.

Harvest One has also entered into a contract to sell its interest in its 398-acre site in Lillooet, British Columbia (the "Lillooet Property") for cash consideration of $770. The transaction is expected to close on March 31, 2020.

Expanded Distribution and Supply Agreements

a) Alberta Supply Agreement

In December 2019, United Greeneries entered into an agreement with Alberta Gaming, Liquor & Cannabis Commission ("AGLC") to supply Royal High™ and Captain's Choice™ branded cannabis throughout Alberta. Under the terms of the agreement, United Greeneries will initially launch five varieties of Royal High™ branded cannabis in whole-flower format as well as two varieties of Captain's Choice™ branded pre-rolled products for sale throughout Alberta in licensed cannabis stores. The Company is also working towards listing new product categories such as oils, vapes and topical creams, to be made available for sale throughout the province.

b) FederalMed Distribution Agreement

In November 2019, Satipharm entered into a distribution agreement with FederalMed to manage the importation and distribution of Satipharm's CBD Gelpell® capsules in Argentina for medical purposes. Argentine law authorises the importation of cannabis products for sufferers of refractory epilepsy for patients with a doctor's prescription. The Company's initial shipment has also been received by the first patient, which marks the Company's first entry into South America and adds to Satipharm's growing distribution network.

Product Development and Licensing

a) Canadian R&D Licence for Satipharm CBD Gelpell®

In November 2019, United Greeneries received permission from Health Canada to import Satipharm's CBD Gelpell® capsules into Canada for research and development purposes. This allows the Company to begin compliance testing and analysis for the Canadian market in anticipation of full-scale production of the CBD Gelpell® capsules in Canada in calendar 2020.

b) Mission Road Cultivation Licence

In October 2019, United Greeneries received a cultivation licence from Health Canada for Phase 1 of its new Mission Road Facility. The licence allowed United Greeneries to immediately begin cultivating cannabis in the new Mission Road Facility located adjacent to its existing Duncan Facility. Once fully completed, the Mission Road Facility is expected to triple the production capacity at Duncan and increase operational efficiency.

Facilities and Expansions

a) Duncan and Mission Road

Expansion is underway at the Mission Road Facility and is approximately 70% complete. When fully constructed and licensed, the Mission Road Facility (collectively, with the Company's existing licensed Duncan Facility, the "Duncan Campus") is expected to triple the output of the Duncan Campus from its original 1,200 kg to approximately 3,500 kg annually.

The design and build of the Mission Road Facility expansion project is comprised of three phases incorporating four modules of state-of-the-art cultivation space. Phase 1 construction has been completed and a cultivation licence for Phase 1 was received from Health Canada in October 2019. The licensing of Phase 1 added an additional 600 kg of annualized cultivation capacity to the Duncan Campus, bringing the current annualized capacity to approximately 1,800 kg. Completion of Phase 2 and Phase 3 will add a further 1,700 kg annually, bringing the aggregate annualized production capacity of the Duncan Campus to approximately 3.500 kg. A further 13 acres of surrounding land at the Mission Road Facility is available for additional expansion.

b) Lucky Lake

The Company's facility located in Lucky Lake, Saskatchewan is a 68,000 square foot concrete agricultural facility situated on 23 acres of land (the "Lucky Lake Facility").

In light of the accelerating and extreme oversupply of cannabis flower in the Canadian marketplace, the Company has recently undergone a redesign and repurposing of the Lucky Lake Facility to focus on the Company's core strengths: namely, the development, production and distribution of the Company's value-added infused products. Specifically, the repurposing of the Lucky Lake Facility will allow the Company to produce cannabis-infused Dream Water and LivRelief™ products, vape and other derivative offerings, as well as offer expanded product development as derivative cannabis products gain traction in the Canadian consumer marketplace. The repurposing of the Lucky Lake Facility will also result in sequential cost savings and reduced capital expenditures on the facility. Depending on future demand for dried flower, the Company could revert to adding back cultivation rooms if and when necessary.

In order to focus capital on the support of its existing operations, the Company has suspended active development of its Lucky Lake and Mission Road facilities. Additional investment in these facilities remains an attractive strategic option subject to obtaining suitable financing to support the further development.

c) Greenbelt and Lillooet

As the commoditization of cannabis cultivation accelerates, the Company is currently undergoing a review of its non-core assets in order to reduce its overall exposure to pure cultivation and redirect its efforts and resources on brand development, production and distribution. To this end, the Company is currently in discussions to divest its 50.1% interest in Greenbelt. In addition, the Company has entered into a contract for purchase and sale in respect of the Lillooet Property for cash consideration of $770. The Lillooet Property closing is scheduled for March 31, 2020.

The sale of these non-core assets will provide cash proceeds to support the expansion of the Company's core business lines and continuing operations. The Company will continue to explore other strategic alternatives for its operations that are currently deemed not critical to the Company's brand development, production and distribution strategy.

OUTLOOK

Management anticipates sales volumes, net revenues, and adjusted EBITDA to improve throughout the remainder of fiscal 2020 due to increased capacity, the introduction of new cannabis derivative products to the Canadian market, improvements in gross margin, and disciplined spending across all segments, including implementation of the Plan which is expected to result in cash cost savings of approximately 30% on an annualized basis.

Cannabis 2.0

Harvest One's initial Cannabis 2.0 product offerings include a selection of pain relief topical creams and vape pen cartridges. Products have undergone the necessary Health Canada notifications and are currently in the process of being listed in Ontario, British Columbia, Alberta, Saskatchewan and Manitoba. All five provinces have completed registrations and the Company is currently working through final arrangements with a production partner from whom products are expected to be available by the end of the third quarter of fiscal 2020. Through this production, LivRelief™ will expand its product offerings with CBD- and THC-infused topical formulations in Canada. Examples of potential new products are depicted below:

LivRelief™
CBD

LivRelief™
THC:CBD

Medical and Nutraceutical

Satipharm continues to ramp up sales of its 10 mg full spectrum CBD Gelpell® capsules and CBD oil online and through brick-and-mortar distribution channels. In fiscal 2020 and future years, Satipharm will expand its product offerings and intends to launch new cannabis-based medical and nutraceutical products. Illustrations of Satipharm's planned new co-formulations for Europe are depicted below:

Satipharm CBD Gelpell® Capsules Focus	Satipharm CBD Gelpell® Capsules Active

Consumer

Delivra intends to commence sales of two OTC LivRelief™ products in the US marketplace in calendar 2020.

Dream Water continues to be forward-thinking with respect to international compliant formulas and line extensions in both the sleep-aids and CBD markets, including lines of products with multiple delivery formats for both categories. Formulation of CBD-infused Dream Water continues to advance and will enter the market when regulations allow in the US. The Company continues to build out a pipeline of innovation that addresses consumers' growing demand for effective sleep aids, in both OTC and cannabinoid-infused formats. Examples of potential new products are depicted below:

Dream Water Non-Melatonin	Dream Water Defense	Dream Water Vitality	Dream Water Sport	Dream Water +CBD

FINANCIAL REVIEW

The Company operates in three reportable segments: cultivation (United Greeneries), medical and nutraceutical (Satipharm and PhytoTech), and consumer (Dream Water and Delivra). The following is a break-down of the gross profit (loss) by segment for the three and six months ended December 31, 2019, and 2018, respectively:

	For the three months ended December 31, 2019				For the three months ended December 31, 2018			
	Cultivation $	Medical and Nutraceutical $	Consumer $	Total $	Cultivation $	Medical and Nutraceutical $	Consumer $	Total $
Net revenue	**(250)**	**107**	**1,911**	**1,768**	2,039	14	1,689	3,742
Cost of sales:								
Production costs	**584**	**—**	**—**	**584**	794	—	—	794
Inventory expensed to cost of sales	**90**	**83**	**1,573**	**1,746**	160	4	1,029	1,193
Gross profit (loss) before fair value adjustment	**(924)**	**24**	**338**	**(562)**	1,085	10	660	1,755
Realized fair value amounts included in inventory sold	**226**	**—**	**—**	**226**	1,770	—	—	1,770
Unrealized change in fair value of biological assets	**(854)**	**—**	**—**	**(854)**	(1,142)	—	—	(1,142)
Gross profit (loss)	**(296)**	**24**	**338**	**66**	457	10	660	1,127

	For the six months ended December 31, 2019				For the six months ended December 31, 2018			
	Cultivation $	Medical and Nutraceutical $	Consumer $	Total $	Cultivation $	Medical and Nutraceutical $	Consumer $	Total $
Net revenue	**1,787**	**406**	**3,639**	**5,832**	2,647	14	2,760	5,421
Cost of sales:								
Production costs	**1,206**	**—**	**—**	**1,206**	1,442	—	—	1,442
Inventory expensed to cost of sales	**1,072**	**330**	**2,964**	**4,366**	193	4	2,155	2,352
Gross profit (loss) before fair value adjustment	**(491)**	**76**	**675**	**260**	1,012	10	605	1,627
Realized fair value amounts included in inventory sold	**931**	**—**	**—**	**931**	2,274	—	—	2,274
Unrealized change in fair value of biological assets	**(2,002)**	**—**	**—**	**(2,002)**	(2,352)	—	—	(2,352)
Gross profit (loss)	**580**	**76**	**675**	**1,331**	1,090	10	605	1,705

Net revenue

Revenue is comprised of sales of: (1) harvested cannabis to both the medical and recreational markets in Canada; (2) CBD Gelpell® capsules in the United Kingdom, Ireland, Argentina and Australia; (3) Dream Water liquid sleep shots and sleep powder packets in Canada and the US, and (4) Delivra natural topical pain relief creams in Canada. Net revenue is determined by deducting excise taxes that are included in gross revenue from cannabis sales in Canada and remitted to the provincial governments, effective October 17, 2018, when the Act went into effect.

For the three and six months ended December 31, 2019, net revenue was $1,768 and $5,832, compared to $3,742 and $5,421 in the same periods in the prior year. The $1,974 decrease and $411 increase in net revenue was due to: (1) $2,289 and $860 decrease in the cultivation segment from lower volumes of recreational cannabis sold in fiscal 2020 compared to sales from the initial provincial load-ins upon legalization in fiscal 2019, as well as returns and pricing adjustments recognized throughout the cannabis industry in the second quarter of fiscal 2020; (2) $93 and $392 increase in the medical and nutraceutical segment from the launch of reformulated CBD Gelpell® capsules as well as CBD oils in calendar 2019; and (3) $222 and $879 increase in the consumer segment from organic growth in Dream Water and the acquisition of Delivra in July 2019.

The total quantity of cannabis sold, excluding bulk cannabis sales to other licensed producers, during the three and six month periods ended December 31, 2019 was 45 kg and 168 kg (December 31, 2018 – 233 kg and 249 kg) at an overall average price of $8.23 and $7.85 per gram (December 31, 2018 – $7.98 and $8.02 per gram).

Cost of sales

Cost of sales is comprised of: (1) production costs; and (2) inventory expensed to cost of sales.

For the cultivation segment, production costs represent the costs of growing cannabis plants including labour related costs, grow consumables, materials, utilities, facility costs, quality and testing costs, production related depreciation, and overheads. Inventory expensed to cost of sales represents packaging and other post-harvest costs.

For the medical and nutraceutical and consumer segments, costs of sales relate to the deemed cost of inventory that is expensed when sold. The cost per unit is expected to decrease as economies of scale are achieved.

For the three and six months ended December 31, 2019, cost of sales was $2,330 and $5,572, compared to $1,987 and $3,794 in the same periods in the prior year. The $343 and $1,778 increase in cost of sales was due to: (1) $544 and $809 increase in the consumer segment primarily from the acquisition of Delivra in July 2019; (2) $79 and $326 increase in the medical and nutraceutical segment from the launch of reformulated CBD Gelpell® capsules, as well as CBD oils in calendar 2019; and (3) $280 decrease and $643 increase in the cultivation segment from lower volumes of recreational cannabis sold during the three months ended December 31, 2019, and the sale of bulk cannabis to other licensed producers during the six months ended December 31, 2019.

Gross margin before fair value adjustments (non-GAAP measure)

The table below outlines gross profit (loss) and gross margin before fair value adjustments for the periods ended December 31, 2019 and 2018, respectively.

	For the three months ended December 31		For the six months ended December 31	
	2019	2018	2019	2018
	$	$	$	$
Net revenue	**1,768**	3,742	**5,832**	5,421
Cost of sales	**2,330**	1,987	**5,572**	3,794
Gross profit (loss) before fair value adjustments	**(562)**	1,755	**260**	1,627
Gross margin before fair value adjustments[(1)]	**(32)%**	47%	**4%**	30%
Gross profit	**66**	1,127	**1,331**	1,705
Gross margin	**4%**	30%	**23%**	31%

(1) Gross margin before fair value adjustments is a non-GAAP measure, which is calculated by excluding non-cash fair value changes as required by IFRS.

Gross margin before fair value adjustments for the three and six months ended December 31, 2019 was (32)% and 4%, respectively, compared to 47% and 30% in the same period in the prior year. The decrease was due primarily to a decline in net sales within the cultivation segment, resulting from lower volumes of recreational cannabis sold, in addition to returns and pricing adjustments recognized during the three and six months ended December 31, 2019.

Included in cost of sales for the three and six months ended December 31, 2019 is a $412 and $769 non-cash fair value charge on inventory related to the acquisition of Delivra (December 31, 2018 – $16 and $468 related to the acquisition of Dream Water).

Fair value adjustments and gross profit (loss)

Included in gross profit (loss) are two fair value adjustments which are excluded from cost of sales: (1) realized fair value amounts included in inventory sold, which relate to the fair value less cost to sell estimate per gram of cannabis sold; and (2) unrealized change in fair value of biological assets, which relates to a non-cash gain recognized based on plant growth through the pre-harvest stages.

Plants in pre-harvest stage are considered biological assets and are capitalized as inventory on the balance sheet at fair value less cost to sell at their point of harvest. Fair value estimates are based directly on the Company's selling prices for specific cannabis strains and estimated or expected selling prices to provincial crown corporations in a regulated domestic market. Costs to sell include post-harvest, trimming, fulfillment, and shipping costs.

At harvest, the biological assets are transferred to inventory at their fair value, which becomes the deemed cost for inventory. Inventory is later expensed to realized fair value amounts included in inventory sold when sold.

For the three and six months ended December 31, 2019, gross profit was $66 and $1,331, compared to $1,127 and $1,705 from the same periods in the prior year. The $1,061 and $374 decrease is due to the factors noted above in net revenue and cost of sales, as well as the unrealized change in fair value of biological assets and the realized fair value of amounts included in inventory sold discussed below.

Realized fair value amounts included in inventory sold decreased by $1,544 and $1,343 for the three and six months ended December 31, 2019, compared to same period in the prior year, due to an decrease in the amount of recreational cannabis sold and furthered by a decrease in the fair value less costs to sell from $6.45 to $6.00 per gram determined based on the assumptions discussed in note 6 of the interim consolidated financial statements.

Unrealized change in fair value of biological assets decreased by $288 and $350 for the three and six months ended December 31, 2019, compared to the same period in the prior year, based on changes in the fair value less costs to sell assumptions, the number of harvests in process and the stage of plant growth through the pre-harvest stages.

Expenses

	For the three months ended December 31		For the six months ended December 31	
	2019	2018	2019	2018
	$	$	$	$
General and administration	**3,797**	2,968	**7,942**	5,639
Sales and marketing	**746**	340	**1,573**	934
Acquisition costs	**33**	14	**33**	44
Research and development	**86**	—	**198**	—
Depreciation and amortization	**628**	107	**1,303**	185
Share-based compensation	**509**	834	**1,206**	2,409
Asset impairment and write-downs	**9,866**	15	**9,866**	347
Severance and reorganization costs	**349**	77	**349**	1,192
	16,014	4,355	**22,470**	10,750

Total expenses increased by $11,659 and $11,720 for the three and six months ended December 31, 2019 compared to the same period in the prior year, primarily due to an increase in: (1) asset impairment and write-downs from goodwill impairment charges recognized in the cultivation and consumer segments, (2) general and administration expenses from expanded operations leading to an increase in headcount across the Company, (3) sales and marketing expenses from ongoing efforts to create brand awareness, and (4) depreciation and amortization from the acquisitions of Delivra and Greenbelt. This increase is offset by lower share-based compensation expense due to the vesting of certain options and performance appreciation rights ("PARs") and lower severance and reorganization costs incurred in the six months ended December 31, 2019. The changes in expenses are detailed below as follows:

General and administration

General and administration expenses increased by $829 and $2,303 for the three and six months ended December 31, 2019, compared to the same period in the prior year, due to the Company's growth and expansion both domestically and internationally. The Company added members to the management team and employees at the Vancouver head office, United Greeneries, Satipharm and Dream Water operations. In addition, the Company incurred additional general and administration expenses as a result of the Delivra acquisition. With the implementation of the Plan during the three months ended December 31, 2019, general and administration expenses are expected to decrease in future periods.

Sales and marketing

Sales and marketing expenses increased by $406 and $639 for the three and six months ended December 31, 2019, compared to the same period in the prior year, primarily due to the Company's ongoing effors to create brand awareness of its cannabis, Satipharm, Dream Water, and Delivra products.

Depreciation and amortization

Depreciation and amortization increased by $521 and $1,118 for the three and six months ended December 31, 2019, compared to the same period in the prior year, due to the Company's acquisition of Delivra and Greenbelt as well as the Company's transition to IFRS 16 – Leases on July 1, 2019. These transactions resulted in an increase of $9,824 in property, plant and equipment, $15,670 in intangible assets, and $928 in right-of-use assets, and thus an increase in depreciation and amortization.

Share-based compensation

Share-based compensation decreased by $325 and $1,203 for the three and six months ended December 31, 2019, compared to the same period in the prior year, due to certain tranches of options and PARs that fully vested in July 2019, resulting in a lower share-based compensation expense during the three and six months ended December 31, 2019.

Asset impairment and write-downs

Asset impairment and write-downs increased by $9,851 and $9,519 for the three and six months ended December 31, 2019, compared to the same period in the prior year, due to goodwill impairment of $1,966 in the cultivation segment and $7,900 in the consumer segment, offset by the write-off of capitalized costs in construction in progress and prepaid expenses and deposits in the prior year related to: (1) the Company terminating the lease for the Aldergrove site; and (2) the previously planned project on the vacant land adjacent to the Duncan Facility prior to the commencement of modular expansion on the land.

Severance and reorganization costs

Severance and reorganization costs increased by $272 and decreased by $843 for the three and six months ended December 31, 2019, compared to the same period in the prior year, due the timing of corporate reorganizations which occurred during the second quarter of fiscal 2020 and the first quarter of fiscal 2019. The reorganization of the senior leadership team in the prior year included a severance payment of $750 to the former CEO of the Company.

Adjusted EBITDA (non-GAAP measure)

	For the three months ended December 31		For the six months ended December 31	
	2019 $	2018 $	2019 $	2018 $
Loss from operations	**(15,948)**	(3,228)	**(21,139)**	(9,045)
IFRS fair value accounting related to biological assets and inventory				
Realized fair value included in inventory sold	**226**	1,770	**931**	2,274
Unrealized change in fair value of biological assets	**(854)**	(1,142)	**(2,002)**	(2,352)
	(16,576)	(2,600)	**(22,210)**	(9,123)
Fair value adjustment in cost of sales	**412**	16	**769**	468
Depreciation and amortization (statement of cash flows)	**721**	175	**1,485**	335
Share-based compensation	**509**	834	**1,206**	2,409
Common shares issued for services	**75**	—	**471**	—
Asset impairment and write-downs	**9,866**	15	**9,866**	347
	11,583	1,040	**13,797**	3,559
Adjusted EBITDA	**(4,993)**	(1,560)	**(8,413)**	(5,564)

For the three and six months ended December 31, 2019, adjusted EBITDA decreased by $3,433 and $2,849 compared to the same period in the prior year, primarily due to lower revenues and an increase in expenses, both as described above.

LIQUIDITY AND CAPITAL RESOURCES

Management of the Company is consistently working to monitor and manage the Company's capital resources to assess if it has access to adequate liquidity to fund its operations and planned expansions. Management's objectives with respect to liquidity and capital structure are to generate sufficient cash to fund the Company's existing operations and growth strategy.

	For the three months ended December 31		For the six months ended December 31	
	2019 $	2018 $	2019 $	2018 $
Cash used in operating activities	**(4,403)**	(3,123)	**(14,608)**	(9,201)
Cash used in investing activities	**(2,071)**	(4,324)	**(4,649)**	(6,746)
Cash (used in) provided by financing activities	**(106)**	150	**(201)**	150
Effect of foreign exchange on cash	**88**	(42)	**(63)**	(67)
Decrease in cash during the period	**(6,492)**	(7,339)	**(19,521)**	(15,864)

Cash used in operating activities was $4,403 and $14,608 for the three and six months ended December 31, 2019, compared to $3,123 and $9,201 for the same period in the prior year. The $1,280 and $5,407 increase in cash used is primarily due to an increase in operational spending to support the growth and expansion of the Company.

Cash used in investing activities was $2,071 and $4,649 for the three and six months ended December 31, 2019, compared to $4,324 and $6,746 for the same period in the prior year. The $2,253 and $2,097 decrease in cash used is mainly attributable to: (1) the timing of payments on the purchase of property, plant and equipment for the continued construction of the Lucky Lake Facility and modular expansion at Mission Road, (2) cash allocated to the Company's investment in Burb in the prior year, and (3) the acquisition of Phytotech in the prior year.

Cash used in financing activities was $106 and $201 for the three and six months ended December 31, 2019, compared to cash provided by financing activities of $150 and $150 for the same period in the prior year. The $256 and $351 increase in cash used pertains to the payment of loans and borrowings assumed from the acquisition of Delivra and the payment of lease liabilities upon the Company's transition to IFRS 16.

The nature of the Company's current business and the source of revenue from operations is the cultivation and sale of cannabis, as well as the production and sale of Dream Water's sleep aid products, Delivra's pain relief consumer packaged goods, and Satipharm's CBD Gelpell® capsules. However, the Company's ability to continue in the normal course of operations is dependent on actions by management achieving profitable operations and raising additional capital. Management believes it will be able to raise capital as required in the long-term, but recognizes the risks attached thereto including without limitation, risks due to changing market conditions. Historically the capital requirements of the Company have been met by equity and debt subscriptions for securities of the Company. Any equity offering will result in dilution to the ownership interests of the Company's shareholders and may result in the dilution to the value of such interests. Although the Company has been successful in the past in obtaining financing, there can be no assurance that it will be able to obtain adequate financing in the future or that the terms of such financing may be favourable to the Company. If adequate financing is not available when required, the Company may be required to delay, scale back, or eliminate various projects and programs, and may be unable to continue in operation. If the Company is unable to achieve profitable operations or raise additional funds it may require, it could have a material adverse effect on the Company's financial condition and future profitability.

The Company had a consolidated net loss of $16,155 and $21,585 and negative operating cash flows of $4,403 and $14,608 for the three and six months ended December 31, 2019 and an accumulated deficit of $75,702 as at December 31, 2019. These conditions indicate the existence of material uncertainties that may cast significant doubt on the Company's ability to continue as a going concern. If for any reason the Company is unable to continue as a going concern, then this could have an impact on the Company's ability to realize assets at their recognized values, in particular goodwill and other intangible assets, and to extinguish liabilities in the normal course of business at the amounts stated in the unaudited condensed consolidated interim financial statements. Management acknowledges that in the absence of securing additional capital there is uncertainty over the Company's ability to meet its funding requirements as they fall due.

SUMMARY OF QUARTERLY RESULTS

Quarter ended	Net revenue $	Gross profit $	Net loss $	Basic and diluted loss per share $
December 31, 2019	1,768	66	(16,155)	(0.07)
September 30, 2019	4,064	1,265	(5,430)	(0.02)
June 30, 2019	3,021	1,096	(13,707)	(0.07)
March 31, 2019	3,023	207	(5,131)	(0.03)
December 31, 2018	3,742	1,127	(3,332)	(0.02)
September 30, 2018	1,679	578	(5,795)	(0.03)
June 30, 2018	513	100	(4,952)	(0.03)
March 31, 2018	33	1,089	(2,425)	(0.02)

Net revenue and gross profit for second quarter of fiscal 2020 decreased compared to the first quarter of fiscal 2020, primarily due to lower volumes of recreational cannabis sold, in addition to returns and pricing adjustments recognized during the three months ended December 31, 2019. Net loss for the second quarter of fiscal 2020 increased compared to the first quarter of fiscal 2020, primarily due to asset impairment and write-downs and severance and reorganization costs.

SHARE CAPITAL

The Company has an unlimited number of Common Shares authorized and the following securities outstanding:

	December 31 2019	As at the date of this MD&A
Common stock	215,079,486	215,079,486
RTO warrants	3,226,468	3,226,468
Brokers' warrants	600,032	600,032
Secondary warrants	600,002	600,002
Convertible debentures warrants	5,901,182	5,901,182
Units Offering warrants	22,115,385	—
Brokers' compensation units warrants	663,461	—
Dream Water warrants	517,000	517,000
Delivra warrants	2,191,502	2,191,502
Stock options	19,428,205	19,428,205
Performance appreciation rights	2,500,000	2,500,000

OFF BALANCE SHEET ARRANGEMENTS

The Company does not have any off-balance sheet arrangements.

TRANSACTIONS WITH RELATED PARTIES

The following expenses were paid to key management personnel of the Company:

	For the three months ended December 31		For the six months ended December 31	
	2019	2018	2019	2018
	$	$	$	$
Salaries and benefits	**369**	349	**920**	829
Severance costs	**73**	77	**73**	864
Directors' fees	**33**	34	**66**	58
Share-based compensation	**416**	651	**847**	2,138
Total	**891**	1,111	**1,906**	3,889

a) *Payments to related parties*

As at December 31, 2019, there was $33 directors' fees owing (June 30, 2019 – $33) included in accounts payable and accrued liabilities.

b) *Severance payments*

During the six months ended December 31, 2018, the Company paid $750 to the former Chief Executive Officer in accordance with the terms of a mutual separation agreement, which is included in severance and reorganization costs.

COMMITMENTS AND CONTRACTUAL OBLIGATIONS

The Company and its subsidiaries enter into contractual agreements from time to time relating to on-going business activities. As at December 31, 2019, the Company has the following total commitments:

	Less than 1 year	Between 2 to 5 years	Total
	$	$	$
Purchase commitments	6,392	13,567	19,959
Extract services commitments	453	377	830
Capital commitments	1,272	—	1,272
	8,117	**13,944**	**22,061**

a) *Purchase commitments*

On July 1, 2019, the Company entered into a premium cannabis supply agreement with Stevens Green, pursuant to which Stevens Green will cultivate and harvest United Greeneries' premium cannabis genetics at their indoor facility in Stevensville, Ontario. As part of this agreement, the Company has annual minimum purchase commitments. In addition, purchase commitments include amounts committed for the purchase of CBD Gelpell® capsules.

b) *Extraction services commitments*

On November 11, 2018, the Company entered into a multi-year Extraction Services Agreement with Valens GroWorks Corp ("Valens") for cannabis extraction and value-added services. As part of this agreement, the Company will ship to or purchase from Valens bulk quantities of dried cannabis over an initial three-year term. Valens will process the cannabis on a fee-for-service basis into bulk resin or other cannabis oil derivative products.

c) *Capital commitments*

On October 17, 2018, the Company entered into an agreement to purchase four custom designed modular buildings to be installed on the land adjacent to the Duncan Facility. Phase one of the project has been completed, with completion of phases two and three anticipated in calendar 2020. The modular buildings are expected to increase the annual production capacity of harvested cannabis. In addition, capital commitments include amounts committed for the construction of the Lucky Lake Facility and for Gelpell® production equipment.

d) *Litigation*

During the six months ended December 31, 2019, United Greeneries Operations Ltd. ("United Greeneries Operations"), a subsidiary of the Company, was named as the defendant in a civil claim (the "Claim") filed in the Supreme Court of British Columbia in respect of the termination of the lease agreement for land and property in Aldergrove, British Columbia in August 2018. The plaintiff is seeking damages for breach of the lease agreement and United Greeneries Operations has defended the Claim and filed a counterclaim. Management's assessment, based on its interpretation of the agreement and independent legal advice, is that the plaintiff may be partly successful with the Claim, subject to a set-off claim by United Greeneries Operations and it is possible that there will be a future cash outflow made by United Greeneries Operations.

FINANCIAL INSTRUMENTS AND OTHER INSTRUMENTS

The Company thoroughly examines the various financial instruments and risks to which it is exposed and assesses the impact and likelihood of those risks. These risks include foreign exchange risk, credit risk, interest rate risk, and liquidity risk.Where material, these risks are reviewed and monitored by the Board of Directors.

The Board of Directors has overall responsibility for the determination of the Company's risk management objectives and policies. The overall objective of the Board is to set policies that seek to reduce risk as far as possible without unduly affecting the Company's competitiveness and flexibility.

Foreign exchange risk

Foreign exchange risk is the risk that the fair value of future cash flows will fluctuate as a result of changes in foreign exchange rates. As at December 31, 2019, the Company is exposed to foreign currency risk through its bank accounts denominated in United States Dollars ("USD"), Euros ("Euros"), British Pounds ("GBP"), Swiss Francs ('CHF"), Australian Dollars ("AUD"), and Israeli New Shekels ("ILS"). A 10% appreciation (depreciation) of USD, Euros, GBP, CHF, AUD, or ILS against the CAD, with all other variables held constant, would result in an immaterial change in the Company's loss and comprehensive loss for the year.

Credit risk

Credit risk is the risk of financial loss to the Company if a customer or counterparty to a financial instrument fails to meet its contractual obligations and arises principally from the Company's trade accounts receivable. The Company's cash and accounts receivable are exposed to credit risk. The risk for cash is mitigated by holding these instruments with highly-rated financial institutions. The Company provides credit to its customers in the normal course of business and has mitigated this risk by managing and monitoring the underlying business relationships. Collection terms on average, are between 30 to 60 days. As at December 31, 2019, the Company does not believe it is exposed to any significant credit risk.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. As at December 31, 2019, the Company is not exposed to any significant interest rate risk.

Liquidity risk

Liquidity risk is the risk that the Company will encounter difficulty in meeting obligations associated with financial liabilities. The Company manages liquidity risk by maintaining sufficient cash balances to enable settlement of transactions. Accounts payable and accrued liabilities on average have maturities of 30 days or less or are due on demand and are subject to normal trade terms. The Company has current assets of $22,531 and current liabilities of $14,125. The Company addresses its liquidity through debt or equity financing obtained through the sale of convertible debentures and common shares. While the Company has been successful in securing financings in the past, there is no assurance that it will be able to do so in the future. Further, the Company's ability to fund operations, to make planned capital expenditures, to execute its growth strategy and to meet scheduled financial commitments depends on the Company's future operating performance and cash flows as well as capital raising, all of which are subject to prevailing economic conditions and financial, business and other factors, some of which are beyond the Company's control. See also "Liquidity and Capital Resources".

Fair value hierarchy

Financial instruments measured at fair value are classified into one of three levels in the fair value hierarchy according to the relative reliability of the inputs used to estimate the fair values. The three levels of the fair value hierarchy are:

- Level 1 – Unadjusted quoted prices in active markets for identical assets or liabilities;
- Level 2 – Inputs other than quoted prices that are observable for the asset or liability either directly or indirectly; and
- Level 3 – Inputs that are not based on observable market data.

During the period ended December 31, 2019, there were no transfers of amounts between fair value levels.

Cash and cash equivalents are classified as Level 1 financial instruments. The Company's other financial instruments, including accounts receivable, and accounts payable and accrued liabilities are carried at cost which approximates fair value due to the relatively short maturity of those instruments.

NON-GAAP MEASURES

Adjusted EBITDA and gross margin before fair value adjustments are non-GAAP measures used by management that do not have any standardized meaning prescribed by IFRS and may not be comparable to similar measures presented by other companies. Management defines adjusted EBITDA as the loss from operations, as reported, before interest, taxes, depreciation and amortization and adjusted for share-based compensation, common shares issued for services, the fair value effects of accounting for biological assets and inventories, asset impairment and write-downs and other non-cash items. Management defines gross margin before fair value adjustments as a percentage of gross profit (loss) before fair value adjustments of accounting for biological assets and inventory over net revenue. Management believes both measures are useful financial metrics to assess the Company's operating performance on a cash basis before the impact of non-cash items, and on an adjusted basis as described above.

RISKS AND UNCERTAINTIES

This section discusses factors relating to the business of Harvest One that should be considered by both existing and prospective investors. The information in this section is intended to serve as an overview and should not be considered comprehensive, and Harvest One may face additional risks and uncertainties not discussed in this section, or not currently known to the Company, or that the Company deems to be immaterial. All risks to Harvest One's business have the potential to influence its operations in a materially adverse manner.

Additional Financing

There is no guarantee that the Company will be able to execute on its planned strategy. The continued development of the Company requires additional financing. The failure to raise such capital could result in the delay or indefinite postponement of current business strategy or the Company ceasing to carry on business. There can be no assurance that additional capital or other types of financing will be available if needed or that, if available, the terms of such financing will be favorable to the Company. If additional funds are raised through issuances of equity or convertible debt securities, existing shareholders could suffer significant dilution. In addition, from time to time, the Company may enter into transactions to acquire assets or the shares of other companies. These transactions may be financed wholly or partially with debt, which may temporarily increase the Company's debt levels above industry standards. Any debt financing secured in the future could involve restrictive covenants relating to capital raising activities and other financial and operational matters, which may make it more difficult for the Company to obtain additional capital and to pursue business opportunities, including potential acquisitions. Debt financings may contain provisions, which, if breached, may entitle lenders to accelerate repayment of loans and there is no assurance that the Company would be able to repay such loans in such an event or prevent the enforcement of security granted pursuant to such debt financing. The Company may require additional financing to fund its operations to the point where it is generating positive cash flows. Negative cash flow may restrict the Company's ability to pursue its business objectives.

New well-capitalized entrants may develop large-scale operations

Currently, the cannabis industry generally is comprised of individuals and small to medium-sized entities, however, the risk exists that large conglomerates and companies who also recognize the potential for financial success through investment in this industry could strategically purchase or assume control of larger or a larger number of dispensaries and cultivation and production facilities, which trend is now being observed by the Company. These potential competitors may have longer operating histories, significantly greater financial, technological, engineering, manufacturing, marketing and distribution resources, and be larger and better capitalized. Larger competitors could establish price setting and cost controls which would effectively "price out" many of the individuals and small to medium-sized entities who currently make up the bulk of the participants in the varied businesses operating within and in support of the medical and adult-use cannabis industry. While the approach of most laws and regulations seemingly deters this type of takeover, this industry remains nascent and as indicated above this trend is being observed, so what the landscape will be in the future remains largely unknown.

The Company's proposed business plan is subject to all business risks associated with new business enterprises, including the absence of any significant operating history upon which to evaluate an investment. The likelihood of the Company's success must be considered in light of the problems, expenses, difficulties, complications and delays frequently encountered in connection with the formation of a new business, the development of new strategy and the competitive environment in which the Company operates. It is possible that the Company will incur losses in the future. There is no guarantee that the Company will be profitable.

Impact of the Illicit Supply of Cannabis

In addition to competition from licensed producers and those able to produce cannabis legally without a licence, the Company also faces competition from unlicensed and unregulated market participants, including illegal dispensaries and black market suppliers selling cannabis and cannabis-based products in Canada.

Despite the legalization of medical and adult-use cannabis in Canada, black market operations remain and are a substantial competitor to the Company's business. In addition, illegal dispensaries and black market participants may be able to: (1) offer products with higher concentrations of active ingredients that are either expressly prohibited or impracticable to produce under current Canadian regulations; (2) use delivery methods, including edibles, concentrates and extract vaporizers, that the Company is currently prohibited from offering to customers in Canada; (3) use marketing and branding strategies that are restricted under the Cannabis Act and Cannabis Regulations; and (4) make claims not permissible under the Cannabis Act and Cannabis Regulations. As these black market participants do not comply with the regulations governing the medical and adult-use cannabis industry in Canada, their operations may also have significantly lower costs.

As a result of the competition presented by the black market for cannabis, any unwillingness by consumers currently utilizing these unlicensed distribution channels to begin purchasing from licensed producers for any reason or any inability or unwillingness of law enforcement authorities to enforce laws prohibiting the unlicensed cultivation and sale of cannabis and cannabis-based products could: (1) result in the perpetuation of the black market for cannabis; (2) adversely affect the Company's market share; and (3) adversely impact the public perception of cannabis use and licensed cannabis producers and dealers, all of which would have a materially adverse effect on the Company's business, operations and financial condition.

Results of Future Clinical Research

Research in Canada, the U.S. and internationally regarding the medical benefits, viability, safety, efficacy, dosing and social acceptance of cannabis or isolated cannabinoids (such as CBD and THC) remains in early stages. There have been relatively few clinical trials on the benefits of cannabis or isolated cannabinoids (such as CBD and THC) and future research and clinical trials may discredit the medical benefits, viability, safety, efficacy, and social acceptance of cannabis or could raise concerns regarding, and perceptions relating to, cannabis. Given these risks, uncertainties and assumptions, prospective purchasers of the Company's securities should not place undue reliance on such articles and reports. Future research studies may reach negative conclusions regarding the medical benefits, viability, safety, efficacy, dosing, social acceptance or other facts and perceptions relating to cannabis, which could have a material adverse effect on the demand for the Company's products with the potential to lead to a material adverse effect on the Company's business, financial condition, results of operations or prospects.

Product Liability

As a manufacturer and distributor of products designed to be ingested by humans, the Company faces the inherent risk of exposure to product liability claims, regulatory action and litigation if its products are alleged to have caused significant loss or injury. In addition, the manufacture and sale of cannabis involve the risk of injury to consumers due to tampering by unauthorized third parties or product contamination. Previously unknown adverse reactions resulting from human consumption of cannabis alone or in combination with other medications or substances could occur. As a manufacturer and distributor of adult-use and medical cannabis, or in its role as an investor in, or service provider to, an entity that is a manufacturer, distributor and/or retailer of adult-use or medical cannabis, the Company may be subject to various product liability claims, including, among other things, that the cannabis product caused injury or illness, include inadequate instructions for use or include inadequate warnings concerning possible side effects or interactions with other substances. A product liability claim or regulatory action against the Company could result in increased costs, could adversely affect the Company's reputation with its clients and consumers generally, and could have a material adverse effect on the business, results of operations, financial condition or prospects of the Company. There can be no assurances that the Company will be able to maintain product liability insurance on acceptable terms or with adequate coverage against potential liabilities. Such insurance is expensive and may not be available in the future on acceptable terms, or at all. The inability to maintain sufficient insurance coverage on reasonable terms or to otherwise protect against potential product liability claims could prevent or inhibit the commercialization of the Company's potential products or otherwise have a material adverse effect on the business, results of operations, financial condition or prospects of the Company.

Product Recalls

Manufacturers and distributors of products are sometimes subject to the recall or return of their products for a variety of reasons, including product defects, such as contamination, unintended harmful side effects or interactions with other substances, packaging safety and inadequate or inaccurate labeling disclosure. Such recalls cause unexpected expenses of the recall and any legal proceedings that might arise in connection with the recall. This can cause loss of a significant amount of sales. In addition, a product recall may require significant management attention. Although the Company has detailed procedures in place for testing its products, there can be no assurance that any quality, potency or contamination problems will be detected in time to avoid unforeseen product recalls, regulatory action or lawsuits. Additionally, if one of the Company's products were subject to recall, the reputations of that product and the Company could be harmed. Additionally, product recalls can lead to increased scrutiny of operations by applicable regulatory agencies, requiring further management attention and potential legal fees and other expenses.

Risks related to vaping and vaping products

On October 4, 2019, the U.S. Food and Drug Administration issued a warning to the public to stop using vaping liquids containing cannabis derivatives and ingredients, such as CBD and THC, in light of a potential but unconfirmed link to lung injuries such as severe pulmonary illness. Such warnings appear to be particularly focused on the use of vaping liquids purchased from unlicensed or unregulated retailers. Lung injuries associated with the use of cannabis derivatives containing vaping liquid have equally been reported in Canada but to a lesser extent. In response, Health Canada has issued an information update advising Canadians who use cannabis derivatives containing vaping liquids to monitor themselves for symptoms of pulmonary illness. There may be further governmental and private sector actions aimed at reducing the sale of cannabis containing vaping liquids and/or seeking to hold manufacturers of cannabis containing vaping liquids responsible for the adverse health effects associated with the use of these vaping products. These actions, combined with potential deterioration in the public’s perception of cannabis containing vaping liquids, may result in a reduced market for vaporizer products. Federal, provincial and local regulations or actions that prohibit or restrict the sale of vaporizer products including cannabis derivative vaping liquids, or that decrease consumer demand for the Company’s products by prohibiting their use, raising the minimum age for their purchase, raising the purchase prices to unattractive levels via taxation, or banning their sale, could adversely impact the financial condition and results of operations of the Company.

If the Company's vaporizer products become subject to increased taxes it could adversely affect the Company's business

Supply to the Company's customers is sensitive to increased sales taxes and economic conditions affecting their disposable income. Discretionary consumer purchases, such as of vaporization products and consumption accessories, may decline during recessionary periods or at other times when disposable income is lower and taxes may be higher. Presently, the sale of vaporization products and certain other consumption accessories is, in certain jurisdictions, subject to federal, provincial and municipal excise taxes like the sale of conventional cigarettes or other tobacco products, all of which generally have high tax rates and have faced significant increases in the amount of taxes collected on their sales. Other jurisdictions are contemplating similar legislation and other restrictions on electronic cigarettes and certain other vaporizer products. Should federal, provincial and municipal governments and/or other taxing authorities begin or continue to impose excise taxes similar to those levied against conventional cigarettes and tobacco products on vaporization products or consumption accessories, it may have a material adverse effect on the demand for those products, as consumers may be unwilling to pay the increased costs, which in turn could have a material adverse effect on the Company's business, results of operations and financial condition. The Company could also become involved in regulatory or agency proceedings, investigations and audits. The Company's business, and the business of the suppliers from which the Company acquires the products it sells, requires compliance with many laws and regulations. Failure to comply with these laws and regulations could subject the Company or such suppliers to regulatory or agency proceedings or investigations and could also lead to damage awards, fines and penalties. The Company or such suppliers may become involved in a number of government or agency proceedings, investigations and audits. The outcome of any regulatory or agency proceedings, investigations, audits, and other contingencies could harm the Company's reputation or the reputations of the brands that it sells, requires it to take, or refrain from taking, actions that could harm the Company's operations or require the Company to pay substantial amounts of money, harming its financial condition. There can be no assurance that any pending or future regulatory or agency proceedings, investigations and audits will not result in substantial costs or a diversion of management's attention and resources or have a material adverse impact on the Company's business, financial condition and results of operations.

In addition to the above, the Company is also subject to the following risks and uncertainties that can significantly affect its financial condition and future operations. The following risk factors are described in greater detail under the heading "Risks and Uncertainties" in the Company's Management's Discussion and Analysis dated October 28, 2019, for the year ended June 30, 2019, available under the Company's profile at www.sedar.com, and such risk factors are hereby incorporated by reference into this document and should be reviewed in detail by all readers:

- The Company can provide no assurance that it will be able to generate sufficient free cash flow or obtain financing to meet its growth needs;
- Harvest One may not be able to achieve or maintain profitability and may continue to incur significant losses in the future;
- Harvest One does not use derivative instruments or hedges to manage risks because Harvest One's exposure to credit risk, interest rate risk and currency risk is small;
- The Company is subject to liquidity risks which are subject to prevailing economic conditions and financial, business and other factors, some of which are beyond the Company's control;
- Harvest One is exposed to foreign currency risk related to cash, accounts receivable and accounts payable and accrued liabilities that are denominated in a foreign currency;
- The Company may be subject to claims or complaints from investors in the ordinary course of business;
- The continuation of the Company's business of growing, storing and distributing medical and adult-use cannabis is dependent on the good standing of all licences required to engage in such activities and upon adhering to all regulatory requirements related to such activities;
- The market price for Harvest One's Common Shares may be volatile and subject to wide fluctuations in response to numerous factors, many of which are beyond Harvest One's control;
- Harvest One currently operates two facilities – the Duncan Facility and Phase 1 of Mission Road;
- The Lucky Lake Facility is currently not licensed by Health Canada under the *Cannabis Regulations* as a facility where the cultivation of cannabis is permitted;
- The Greenbelt Facility is currently not licensed by Health Canada under the *Cannabis Regulations* as a facility where the cultivation and processing of cannabis is permitted;
- The construction of the Lucky Lake Facility, and the expansion of the Duncan Facility are subject to various potential problems and uncertainties and such construction and expansion may be delayed or adversely affected by a number of factors beyond Harvest One's control;
- Harvest One is a holding company and essentially all of its operating assets are the capital stock of its subsidiaries;
- Harvest One, through its wholly-owned indirect subsidiary United Greeneries, entered the medical cannabis business in 2012, and the recreational cannabis market in October 2018, and is therefore subject to many of the risks common to entering a new area of investment, including under-capitalization, cash shortages, limitations with respect to personnel, financial and other resources, and a lack of revenue;

- The success of the medical and recreational cannabis industries may be significantly influenced by the public's perception of cannabis' medicinal and recreational applications;
- Harvest One relies on third party transportation services to deliver its products to its customers;
- Harvest One may be subject to growth-related risks including capacity constraints and pressure on its internal systems and controls;
- The Company may have or has integration risks associated with all of its acquisitions;
- The anticipated benefits of new partnerships the Company is pursuing may have a material adverse effect on the Company's business, financial condition and results of operations, as well as its future prospect for acquisitions or partnerships;
- The success of Harvest One is dependent upon the ability, expertise, judgment, discretion and good faith of its senior management and key employees;
- Certain of Harvest One's directors and officers are also directors and operators of other companies;
- MMJ is Harvest One's largest shareholder and will have a significant influence on determining the outcome of any corporate transaction or other matter submitted to shareholders for approval;
- Harvest One has not paid dividends in the past and does not anticipate paying dividends in the near future;
- There can be no assurance that an active and liquid market for Common Shares will be maintained and an investor may find it difficult to resell any securities of Harvest One;
- Harvest One may become party to litigation, mediation and/or arbitration from time to time in the ordinary course of business which could adversely affect its business;
- The parties with which the Company does business may perceive that they are exposed to reputational risk as a result of the Company's lawful cannabis business activities;
- The ownership and protection of trademarks, patents, trade secrets and intellectual property rights are significant aspects of the Company's future success;
- Harvest One may be affected by possible political or economic instability;
- An economic downturn of global capital markets has been shown to make the raising of capital by equity or debt financing more difficult;
- There is a risk that banking institutions in countries where the Company operates or intends to operate in the future will not accept payments related to the cannabis industry;
- The introduction of new products embodying new technologies and regulatory developments may render the Company's equipment obsolete and its products and services less competitive or less marketable;
- The Company holds finished goods in inventory and its inventory has a shelf life;
- The Company may not be able to maintain an effective quality control system;
- The Company's manufacturing processes are dependent upon certain critical pieces of equipment which, on occasion, will be out of service due to routine scheduled maintenance or as a result of equipment failures;
- The Company is subject to credit risk of its clients, and its profitability and cash flow are dependent on receipt of timely payments from clients;
- Sales of the Company's products may be made pursuant to individual purchase orders or contracts and not under long-term commitment;
- The Company may in the future expand into other geographic areas, which could increase its operational, regulatory, compliance, reputational and foreign exchange rate risks;
- The Company's operations at various times may be exposed to political, economic and other risks and uncertainties associated with operating in a foreign jurisdiction;
- The legal and regulatory requirements and local business culture and practices in the foreign countries in which the Company may expand are different from those in which it currently operates;
- Certain Common Shares held by the Company's directors, executive officers, Control Persons and certain other securityholders of the Company are subject to escrow and seed share resale restrictions pursuant to the policies of the TSX-V;
- The trading market for the Common Shares will, to some extent, depend on the research and reports that securities or industry analysts publish about the Company or its business;
- The Company will operate and will be subject to income tax and other forms of taxation (which are not based upon income) in multiple tax jurisdictions;

- There may be income tax consequences in relation to the Common Shares, which will vary according to circumstances of each investor;
- Harvest One, and its subsidiaries, operate in a new industry which is highly regulated, highly competitive and evolving rapidly, and as such management may not be able to predict all such risks or be able to predict how such risks may result in actual results;
- Harvest One will incur ongoing costs and obligations related to compliance with environmental and employee health and safety matters;
- Harvest One's operations are subject to a variety of laws, regulations and guidelines relating to the cultivation, processing, management, transportation, storage, sale and disposal of medical and adult-use cannabis, but also including laws and regulations relating to health and safety, privacy, the conduct of operations and the protection of the environment;
- The impact of changes in the regulatory enforcement by Health Canada under the *Cannabis Act* and the *Cannabis Regulations*, particularly in respect of product packaging, labelling, marketing, and advertising and promotions and product approvals and its impact on Harvest One's business are currently unknown;
- The evolving legal regime presents a risk to Harvest One in that legislators or the court may adopt changes that would have a negative impact on the business, financial condition or results of operations of the Company;
- Restrictions on sales and marketing activities imposed by Health Canada, various medical associations, other governmental, quasi-governmental bodies or voluntary industry associations may adversely affect Harvest One's ability to conduct sales and marketing activities and could have a material adverse effect on Harvest One's respective businesses, operating results and financial conditions;
- A security breach at one of the Company's facilities could expose the Company to additional liability and to potentially costly litigation, increase expenses relating to the resolution and future prevention of these breaches and may deter potential cannabis consumers from choosing the Company's products;
- Those employed at or investing in legal and licensed Canadian cannabis companies could face detention, denial of entry or lifetime bans from the U.S. for their business associations with cannabis businesses;
- The Company has operations in international markets and may have operations in emerging markets in the future, which may expose the Company to the socioeconomic conditions as well as the laws governing the cannabis industry in such countries;
- The number of licences granted by Health Canada could have an adverse impact on the operations of Harvest One;
- Harvest One's business revolves around the growth of cannabis, an agricultural product, and the risks inherent in agricultural businesses will apply;
- Harvest One's cannabis growing operations consume considerable energy, making Harvest One vulnerable to rising energy costs;
- The price of cultivation, processing, sale and distribution of cannabis will fluctuate widely due to how young the cannabis industry is and is affected by numerous factors beyond Harvest One's control;
- Harvest One faces the inherent risk of product liability claims, regulatory actions and litigation if its products are alleged to have caused loss or injury;
- If any of the Company's products are recalled due to an alleged product defect or for any other reason, the Company could be required to incur the unexpected expense of the recall and any legal proceedings that might arise in connection with the recall;
- While Harvest One believes its insurance coverage addresses all material risks to which they are exposed and is adequate and customary in its current state of operations, such insurance is subject to coverage limits and exclusions and may not be available for all the risks and hazards to which Harvest One is exposed;
- Although Harvest One believes that the articles, reports and studies support its beliefs regarding the medical benefits, viability, safety, efficacy, dosing and social acceptance of cannabis, future research and clinical trials may prove such statements to be incorrect, or could raise concerns regarding, and perceptions relating to, cannabis;
- The ability of Harvest One to compete and grow will be dependent on it having access, at a reasonable cost and in a timely manner, to skilled labor, equipment, parts and components;
- Harvest One may decide to invest with certain strategic investors and/or other third parties through joint ventures or other entities, and these parties may have different interests or superior rights to those of Harvest One;
- Harvest One must rely largely on its own market research to forecast sales as detailed forecasts are not generally obtainable from other sources at this early stage of the industry;
- Harvest One's ability to secure long-term profitability and success through the sustainable and profitable operation of its business may be adversely affected by competition from synthetic cannabis production and other technological advances; and

- The Company is exposed to the risk that its employees, independent contractors, and consultants may engage in fraudulent or other illegal activity.

CRITICAL ACCOUNTING JUDGEMENTS AND ESTIMATES

The preparation of the consolidated financial statements requires management to make judgments and estimates and form assumptions that affect the reporting amounts of assets and liabilities at the date of the consolidated financial statements and reporting amounts of revenues and expenses during the reporting period. On an ongoing basis, management evaluates its judgments and estimates in relation to assets, liabilities, revenue, and expenses. Management uses historical experience and various other factors it believes to be reasonable under the given circumstances as the basis for its judgments and estimates. Actual outcomes may differ from these estimates under different assumptions and conditions.

A detailed summary of all of the Company's significant accounting policies is included in Note 2 to the annual audited consolidated financial statements for the year ended June 30, 2019.

Areas that often require significant management estimates and judgement include biological assets and inventory, the estimated useful lives and depreciation of property, plant and equipment, the estimated useful lives and amortization of intangible assets, goodwill, share-based compensation, warrants, accruals, provisions and the determination of the functional currency. The following is an outline of the estimates that the Company considers as critical in the preparation of its consolidated financial statements:

- The Company fair values its biological assets and inventory which requires estimates and assumptions on the stage of growth of the cannabis plants up to the point of harvest, harvesting costs, selling costs, average selling price, wastage and expected yields for the cannabis plants.
- The Company has recorded depreciation and amortization which requires estimates of the useful lives and when the asset is available for use, which are determined through the exercise of judgment. The assessment of any impairment of these assets is dependent upon estimates of recoverable amounts that consider factors such as economic and market conditions and the useful lives of the assets.
- The Company has recorded stock-based compensation using the Black-Scholes Pricing Model, which includes key estimates such as the rate of forfeiture of options or PARs granted, the expected life of the option or PAR, the volatility of the Company's share price, and the risk-free interest rate.
- The Company has recorded certain warrants using the Black-Scholes Pricing Model, which requires includes key estimates such as the expected life of the warrants, the volatility of the Company's share price, and the risk-free interest rate. With respect to the share purchase warrants acquired from Burb, the only difference in key estimates is the volatility used which is based on the historical volatility of comparable public companies.
- Judgement is used in determining whether an acquisition is a business combination or an asset acquisition. The Company must determine whether it is the acquirer or acquiree in each acquisition. Under IFRS 3 – Business Combinations, the acquirer is the entity that obtains control of the acquiree in the acquisition. If it is not clear which entity is the acquirer, additional information must be considered, such as the combined entity's relative voting rights, existence of a large minority voting interest, composition of the governing body and senior management, and the terms behind the exchange of equity interest.

The Company performs an annual impairment test for goodwill and indefinite life intangible assets in the fourth quarter of its fiscal year by comparing the carrying value of each cash-generating unit ("CGU") containing the assets to its recoverable amount. At the end of each reporting period, the Company assesses whether there were events or changes in circumstances that would indicate that an asset may be impaired. If any such indication exists, the Company shall estimate the recoverable amount of the asset. An impairment loss is recognized for the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of the asset's fair value less costs of disposal and value-in-use. Determining whether an impairment has occurred requires valuation of the respective CGU, which management estimates using a discounted cash flow method. The discounted cash flow method uses estimates and assumptions, including actual operating results, future business plans, economic projections and market data.

RECENT ACCOUNTING PRONOUNCEMENTS

The Company has adopted the following new or amended IFRS standards for the period beginning July 1, 2019.

IFRS 16 – Leases ("IFRS 16")

IFRS 16 was issued by the International Accounting Standards Board ("IASB") replacing IAS 17 – Leases ("IAS 17") and related interpretations and is effective for annual periods beginning on or after January 1, 2019. IFRS 16 eliminates the current operating/finance lease dual accounting model for lessees and replaces it with a single, on-balance sheet accounting model, similar to the previous finance lease accounting.

The Company has updated its accounting policy for leasing to reflect the adoption of IFRS 16 as detailed below.

<u>Definition of a lease</u>

At inception of a contract, the Company assesses whether a contract is, or contains, a lease. A contract is, or contains, a lease if the contract conveys the right to control the use of an identified asset for a period of time in exchange for consideration. To assess whether a contract conveys the right to control the use of an identified asset, the Company assesses whether:

- the contract involves the use of an identified asset - this may be specified explicitly or implicitly and should be physically distinct or represent substantially all of the capacity of a physically distinct asset. If the supplier has a substantive substitution right, then the asset is not identified;
- the Company has the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use; and
- the Company has the right to direct the use of the asset. The Company has the right when it has the decision-making rights that are most relevant to changing how and for what purpose the asset is used.

<u>Accounting as a lessee</u>

For contracts that contain a lease, the Company recognises a right-of-use asset and a lease liability at the lease commencement date.

The right-of-use asset is initially measured at cost, which comprises the initial amount of the lease liability adjusted for any lease payments made at or before the commencement date, plus any initial direct costs incurred and an estimate of costs to dismantle and remove the underlying asset or to restore the underlying asset or the site on which it is located, less any lease incentives received.

The right-of-use asset is subsequently depreciated using the straight-line method from the commencement date to the earlier of the end of the useful life of the right-of-use asset or the end of the lease term. The estimated useful lives of right-of-use assets are determined on the same basis as those of property, plant and equipment. In addition, the right-of-use asset is assessed for impairment losses, should a trigger be identified and adjusted for impairment if required.

The lease liability is initially measured at the present value of the lease payments that are not paid at the commencement date, discounted using the interest rate implicit in the lease, or if that rate cannot be readily determined, the Company's incremental borrowing rate. Generally, the Company uses its incremental borrowing rate as the discount rate. Lease payments included in the measurement of the lease liability is comprised of fixed lease payments and lease payments in an option renewal period if the Company is reasonably certain to exercise an extension option, and penalties for early termination of a lease unless the Company is reasonably certain not to terminate early.

The lease liability is measured at amortised cost using the effective interest method. It is remeasured when there is a change in future lease payments arising from a change in an index or rate or if the Company changes its assessment of whether it will exercise an extension or termination option. When the lease liability is remeasured in this way, a corresponding adjustment is made to the carrying amount of the right-of-use asset.

The Company presents right-of-use assets in 'property, plant and equipment' and lease liabilities in 'loans and borrowings' in the statement of financial position.

<u>*Short-term leases and lease of low-value assets*</u>

The Company has elected not to recognize right-of-use assets and lease liabilities for short-term leases that have a lease term of 12 months or less and leases of low-value assets. The Company recognizes the lease payments associated with these leases as an expense on a straight-line or other systemic basis over the lease term.

<u>*Critical accounting estimates and judgments*</u>

In determining the lease term, management considers all facts and circumstances that create an economic incentive to exercise an extension option, or not exercise a termination option. The assessment is reviewed upon a trigger by a significant event or a significant change in circumstances.

Certain leases contain non-lease components, excluded from the right-of-use asset and lease liability, related to operating charges. Judgment is applied in determination of the stand-alone price of the lease and non-lease components.

Transition to IFRS 16

The Company adopted IFRS 16 using the modified retrospective method which does not require restatement of comparative periods. Therefore, the comparative information has not been restated and continues to be reported under IAS 17.

The Company used the following additional practical expedients:

- applied a single discount rate to a portfolio of leases with similar characteristics;
- applied the exemption not to recognize right-of-use assets and lease liabilities for short-term leases with terms less than 12 months and leases of low-value assets. The Company recognizes the lease payments associated with these leases as an expense on a straight-line or other systemic basis over the lease term;
- excluded initial direct costs from the measurement of the right-of-use asset at the date of initial application; and
- used hindsight when determining the lease term of the contract contains options to extend or terminate the lease.

The Company elected to measure the right-of-use assets at the amount equal to the lease liabilities, adjusted by the amount of any prepaid or accrued lease payments. On transition to IFRS 16, the Company recognized $856 of right-of-use assets, net of accrued lease payments of $26, and $882 of lease liabilities. When measuring lease liabilities, the Company discounted lease payments using its incremental borrowing rate at July 1, 2019. The weighted-average rate applied is 14.5%.

Operating lease commitments at June 30, 2019	1,759
Discounted using the incremental borrowing rate at July 1, 2019	14.5%
Finance lease liabilities recognized as at June 30, 2019	**1,282**
Recognition exception for leases of low-value assets	(89)
Scope changes due to IFRS 16	(311)
Lease liabilities at July 1, 2019	**882**

For leases that were classified as finance leases under IAS 17, the carrying amounts of the right-of-use asset and the lease liability at July 1, 2019, are determined as the carrying amounts of the lease asset and lease liability under IAS 17 immediately before that date.

MANAGEMENT'S RESPONSIBILITY FOR FINANCIAL STATEMENTS

Information provided in this MD&A, including the consolidated financial statements, is the responsibility of management. In the preparation of these consolidated financial statements, estimates are sometimes necessary to make a determination of future value or certain assets or liabilities. Management believes such estimates have been based on careful judgments and have been properly reflected in the accompanying consolidated financial statements. Management maintains a system of internal controls to provide reasonable assurance that the Company's assets are safeguarded and to facilitate the preparation of relevant and timely information.

MANAGEMENT'S REPORT ON DISCLOSURE CONTROLS AND PROCEDURES

Management of the Company has established processes to provide them sufficient knowledge to support representations that they have exercised reasonable diligence that (i) the unaudited condensed consolidated interim financial statements do not contain any untrue statement of material fact or omit to state a material fact required to be stated or that is necessary to make a statement not misleading in light of the circumstances under which it is made, as of the date of and for the periods presented by the consolidated financial statements; and (ii) the unaudited condensed consolidated interim financial statements fairly present in all material respects the financial condition, results of operations and cash flows of the Company, as of the date of and for the periods presented. There have been no significant changes in the Company's disclosure controls and procedures during the three and six months ended December 31, 2019.

LIMITATIONS OF CONTROLS AND PROCEDURES

The Company's management, including the Chief Executive Officer and the Chief Financial Officer, believe that any system of controls and procedures over financial reporting and disclosure, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, they cannot provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been prevented or detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by unauthorized override of the control. The design of any system of controls also is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Accordingly, because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.