

MECHANICAL TECHNOLOGY INCORPORATED
Internal Control Policy
(Effective 5-6-15)

The Internal Control Policy shall apply to the directors and employees of, and other individuals providing bona fide services to, MTI and any of its affiliates (individually and collectively, "MTI" or the "Company").

PURPOSE:

To set forth MTI's policy concerning the principles and requirements of an effective internal control environment. The policy applies to operations, financial reporting and compliance objectives.

POLICY:

It is the policy of MTI to comply strictly, in all respects, with this policy. There are no exceptions to this policy and it may not be compromised or qualified by anyone acting for MTI.

Each employee has an individual obligation and responsibility to comply with the intent, as well as with the words, of this policy. All employees are expected to serve the Company with judgment, discretion and integrity in performing their duties. Relations of a compromising nature or even the appearance of such relations will be scrupulously avoided. Each employee should have a general working knowledge of permissible activities involved in his or her area of work, and should seek guidance from a direct supervisor concerning any matter on which he or she desires clarification.

Managerial personnel have an obligation to implement this policy and to ensure compliance by all employees within their respective areas whose job duties may expose them to the conditions outlined herein. The provisions of this policy will be reviewed with employees on an annual basis; in addition, its provisions will be brought to the attention of new employees when they report for work.

Internal Control

Internal control, as defined by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), is "a process, effected by an entity's board of directors, management and other personnel, designed to provide reasonable assurance regarding the achievement of objectives in the following categories: effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations."

Internal control is the integration of the activities, plans, attitudes, policies, and efforts of the employees of a company working together to provide reasonable assurance that the company will achieve its mission and accomplish certain goals and objectives. Internal control is what a department does to see that the things they want to happen **will** happen and the things they don't want to happen **won't** happen.

An effective internal control system will:

- Promote orderly, economical, efficient and effective operations.
- Produce quality products and services consistent with the company's mission.
- Safeguard resources against loss due to waste, abuse, mismanagement, errors and fraud.
- Promote adherence to statutes, regulations, bulletins and procedures.
- Develop and maintain reliable and accurate financial and management data, and accurately report that data in a timely manner.

Management's Commitment

A successful internal control environment requires management's commitment and support. Management's goal is not to make each person an expert in internal controls, but to increase awareness and understanding of why we need them and how we use them. Executive management is committed to

our internal control program and strongly encourages adherence to the program for the betterment of the Company.

Responsibility

The Finance Department is assigned the responsibility to oversee and coordinate the Company's Internal Control Program. The CFO is responsible for the implementation of this program with the Corporate Accountant responsible for maintaining the testing. Although management is primarily responsible for implementing internal controls, every employee participates in establishing, properly documenting and maintaining internal controls.

Employees are responsible for complying with internal controls by:

- Successfully fulfilling the duties and responsibilities established in their job description and during annual performance reviews.
- Monitoring work to ensure it is done properly and that errors are corrected promptly.
- Meeting applicable performance standards.
- Taking all reasonable steps to safeguard assets against waste, loss, unauthorized use and misappropriation.
- Adhering to all applicable policies and procedures.
- Attending education and training programs to increase awareness and understanding.
- Immediately reporting breakdowns in internal control systems to their supervisor or manager.
- Annually certifying that they have read, understood and complied at all times with the Company's policies contained in the Employee Handbook.

Managers and supervisors are responsible for executing control policies and procedures within their departments by:

- Maintaining a positive office environment that encourages compliance with internal controls.
- Documenting policies and procedures that are to be followed in performing office functions.
- Identifying the control objectives for each function and implementing cost effective controls designed to meet those objectives.
- Regularly testing the controls to verify they are performing as intended.

Board and audit committee members are responsible for executing control policies and procedures by:

- Successfully fulfilling their duties and oversight responsibilities established in the committee charters and for their responsibility for management's development and performance of internal control.
- Defining, maintaining and periodically evaluating the skills and expertise needed among its members to enable them to ask probing questions of senior management and take commensurate actions.
- Maintaining a sufficient amount of members who are independent from management and can be objective in evaluations and decision-making.
- Encouraging adherence to control policies and procedures throughout the organization.
- Effectively communicating to management any matters that could affect the Company's internal control structure.
- Monitoring and ensuring resolution of any deficiencies (either major deficiencies or internal control deficiencies) brought to the attention of the audit committee or the board.

The COSO Internal Control Framework

COSO identifies five inter-related basic components of internal control and 17 internal control principles that must be present and functioning in order for management to conclude that its system of internal control is effective.

Control Environment: The control environment, sometimes referred to as “tone at the top,” is the foundation for all other components of internal control and is a product of management’s governance. The control environment is influenced by management’s philosophy, operating style, integrity, ethical values, and commitment to competence. Senior management establishes a tone at the top by expressing their support in implementing and maintaining effective internal controls. This tone should successfully integrate ethical values and integrity, sound reporting structures, appropriate levels of authority and responsibility, the independence of senior management, and a commitment to attract and retain competent individuals. Internal controls are most effective in a positive control environment. Management helps foster a positive control environment by practicing the most effective philosophy, style and supportive attitude and maintaining high levels of morale. If this foundation is strong, if the control environment is positive, the overall system of internal control will be more effective.

Five Principles:

1. Organization demonstrates a commitment to integrity and ethical values.
2. Board of directors demonstrates independence from management and exercises oversight of the development and performance of internal control.
3. Management establishes, with board oversight, structures, reporting lines, and appropriate authorities and responsibilities in the pursuit of objectives.
4. Organization demonstrates a commitment to attract, develop, and retain competent individuals in alignment with objectives.
5. Organization holds individuals accountable for their internal control responsibilities in the pursuit of objectives.

Risk Assessment: Risk assessment is the identification, analysis, and management of risks relevant to the achievement of the Company’s goals and objectives. Risks include internal and external events or circumstances that may occur and adversely affect operations. Objectives must be clearly defined for a risk assessment to be most effective. Once risks are identified, management should consider their impact (or significance), the likelihood of their occurrence, and how to manage them. When assessing risks, management should consider changes in the external business environment, internal business model, and the potential for fraudulent activities.

Four Principles:

6. Organization specifies objectives with sufficient clarity to enable the identification and assessment of risks relating to objectives.
7. Organization identifies risks to the achievement of its objectives across the entity and analyzes risks as a basis for determining how the risks should be managed.
8. Organization considers the potential for fraud in assessing risks to the achievement of objectives.
9. Organization identifies and assesses changes that could significantly impact the system of internal control.

Control Activities: Internal control activities are tools - policies, procedures, techniques, and mechanisms - that help ensure management's directives are carried out. Control activities help identify, prevent or reduce the risks that can impede accomplishment of the department's objectives. Control activities occur throughout the organization, at all levels and in all functions (including technology). These activities include, but are not limited to, segregation of duties, supervisory review and approvals, authorizations, verifications, reconciliations, documentation, and safeguarding of assets. Management should establish appropriate control activities, as well as employee expectations in performing these activities, in all policies and relevant procedures to help ensure management's directives to mitigate risks are carried out.

Three Principles:

10. Organization selects and develops control activities that contribute to the mitigation of risks to the achievement of objectives to acceptable levels.

11. Organization selects and develops general control activities over technology to support the achievement of objectives.

12. Organization deploys control activities through policies that establish what is expected and procedures that put policies into action.

Communication and Information: In order to run and control our operations, we must have relevant, valid, reliable, and timely communications relating to internal and external events. Managers must be able to obtain reliable information to make informed business decisions, determine their risks, and communicate policies and other important information to those who need it. Communication of relevant, reliable, and quality information is essential in carrying out internal control responsibilities. Objectives and responsibilities for internal control are communicated internally, allowing employees to understand the importance of, as well as their role in, maintaining effective internal controls. Matters affecting the functioning of other components of internal control are communicated externally. Use of effective communication provides the information necessary to carry out the day-to-day internal control activities.

Three Principles:

13. Organization obtains or generates and uses relevant, quality information to support the functioning of internal control.

14. Organization internally communicates information, including objectives and responsibilities for internal control, necessary to support the functioning of internal control.

15. Organization communicates with external parties regarding matters affecting the functioning of internal control.

Monitoring: The Company's internal control system needs to be monitored to assess whether controls are adequate and effective and operating as intended. On-going monitoring occurs through routine managerial activities such as supervision, reconciliations, checklists, comparisons, performance evaluations, and status reports. Monitoring of internal controls should be ongoing and may also occur through separate internal evaluations (e.g., internal audits/reviews) or from use of external sources (e.g., comparison to peer groups or industry standards, surveys, etc.). Identified weaknesses or deficiencies found during monitoring need to be reported to those responsible for the function in a timely manner. Deficiencies that are more serious in nature must be reported to senior management and the board. Corrective actions must also be regularly monitored to ensure they are implemented timely and effectively.

Two Principles:

16. Organization selects, develops, and performs ongoing and/or separate evaluations to ascertain whether the components of internal control are present and functioning.

17. Organization evaluates and communicates internal control deficiencies in a timely manner to those parties responsible for taking corrective action, including senior management and the board of directors, as appropriate.

Types of Control

Controls can be either preventative or detective. Preventative controls attempt to deter or prevent undesirable events from occurring. Separation of duties, proper authorization, adequate documentation, passwords and physical control over assets are all examples of preventative controls. Detective controls attempt to detect errors or irregularities that have already occurred. Reviews, analyses, reconciliations, periodic physical inventories and audits are all examples of detective controls. Both types of controls are essential to an effective internal control system. From a quality standpoint, preventative controls are essential because they are proactive. However, detective controls play a critical role providing evidence that preventative controls are functioning effectively.

Control Activities

The following internal controls can be used to ensure management policies and procedures are adhered to:

- Implement segregation of duties that divide responsibilities among different employees to reduce the risk of error or inappropriate actions.
- Ensure transactions are properly authorized.
- Ensure records are routinely reviewed and reconciled to verify that transactions have been properly processed.
- Provide employees with appropriate training and guidance to ensure they have the knowledge necessary to carry out their job duties, are provided with an appropriate level of direction and supervision and are aware of the proper channels for reporting improprieties.
- Make certain equipment is secured physically and regularly reconciled to inventory records. Passwords and other restricted or confidential information should be protected against theft, destruction, deterioration or misuse.
- Make sure policies and operating procedures are formalized and communicated to employees. Documenting policies and procedures and making them accessible to employees helps provide day-to-day guidance to staff and will promote continuity of activities in the event of prolonged employee absences or turnover.

Responsibility

Internal controls are the responsibility of all employees and board members. Generally, an employee's position will determine the extent of his or her involvement. Internal control is developed by people, it guides people, it provides people with a means of accountability and people carry it out. While everyone has responsibility for ensuring the system of internal control is effective, the greatest amount of responsibility rests with the managers. Internal controls are the structure, policies and procedures used to ensure that management accomplishes its objectives and meets its responsibilities.

In order for internal controls to be effective, employees should:

- Read and understand the policies and procedures related to their position.
- Report any control weaknesses to their supervisor or manager that would prohibit them from successfully fulfilling the responsibilities of their position.
- Adhere to management policies and standards.

- Implement *separation of duties* among different employees to reduce the risk of error or inappropriate actions; ensure no one person has complete control over all aspects of any financial transaction.
- Ensure records are routinely reviewed and reconciled by someone other than the preparer to determine that transactions have been processed accurately and appropriately.
- Ensure that cash, equipment, inventories, and other property are secured physically, counted periodically, and compared to control records; limit access only to authorized persons.
- Provide employees with the appropriate training, direction, and supervision to ensure they have the necessary knowledge and skills to carry out their duties; inform employees of the proper channels for reporting suspected improprieties.
- Make sure statewide and department-level policies and procedures are formalized, documented, communicated and readily available to employees; document day-to-day operating procedures and practices to provide staff with guidance to ensure management's directives are carried out and to help maintain continuity of operations in the event of prolonged employee absences or turnover.

What is meant by the terms “fraud,” “waste” and “abuse”?

Note: The following descriptions do not represent legal advice and are provided solely to give some context to these commonly used terms; please consult with our legal counsel for further guidance:

Fraud: Generally defined in the law as an intentional act to deceive or cheat, ordinarily for the purpose or result of causing a detriment to another and/or bringing about some benefit to oneself or others. Under common law, three elements are required to prove fraud: (1) a material false statement made with intent to deceive; (2) a victim's reliance on the statement; and (3) damages.

Waste: Significant loss or misuse of the Company's resources that results from deficient or negligent practices, controls, or decisions. Waste involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary given the facts and circumstances. Waste does not necessarily involve fraud or other violations of law.

Abuse: Grossly intentional, wrongful, or improper use of the Company's resources or misuse of rank, position, or authority. Abuse involves behavior that is deficient or improper when compared with behavior that a prudent person would consider reasonable and necessary given the facts and circumstances. Abuse does not necessarily involve fraud or other violations of law.

Risk Management

The underlying theme throughout understanding internal controls is to (1) identify risks that may prevent objectives from being achieved and (2) do what is necessary to manage those risks. Thus, setting goals and objectives is a precondition to internal controls.

Each department within the Company must align its objectives to support our strategy. As such, these departments must assess and monitor the risks associated with these goals, and implement adequate controls to help achieve these objectives. Such controls may include conducting background checks to ensure the organizations that we partner with conduct business with a high level of integrity, utilizing contract agreements to protect our ownership of end products, enhancing IT infrastructure and security to mitigate the inherent risks of expanding the online learning environment, and reconciling accounts regularly. The process of identifying and analyzing risk is ongoing, and is a critical component of an effective internal control system. Attention must be focused on risks at all levels, as well as the necessary actions that must be taken to effectively manage them. Risk can pertain to both internal and external factors, such as:

External factors:

- Economic changes
- Changing customer needs or expectations
- New or changed legislation or regulations
- Technological developments
- Natural catastrophes

Internal factors:

- New personnel
- New or revamped information systems
- Changes in management responsibilities
- Unfamiliarity with policies or procedures

Measuring Risk - The Risk Assessment

The framework for the internal control program is based on identifying and testing the programs and administrative functions necessary for our company to carry out its mission. Functions can be identified through organizational charts, departmental budgets, policy and procedural manuals, job descriptions, and information systems. The identified functions are referred to as "assessable units."

To properly assess the current level of risk associated with a function, risk assessments address such factors as:

- Management's attitude towards maintaining effective internal control systems,
- Technical or administrative complexity,
- The existence of adequate organizational charts, lines of communication, and clear designation of work assignments,
- Demonstrated adherence to prescribed policies and procedures,
- The fiscal implications of the function including budget management, handling of cash receipts and disbursements, or contract approvals,
- The sensitive nature of the function and the extent to which decisions can be influenced by external sources, time constraints, or conflicts of interest,
- The professional training and technical proficiency of staff needed to perform the function,
- The stability of the operation in terms of changes in functional responsibilities resulting from staff turnover, permanence of the functional unit and reconfigurations of the organizational structure,
- The frequency of internal or external audits and the significance of the findings, and
- The inherent risk associated with the function regardless of the existence of adequate internal controls.

Internal Control Review

The need for a more in-depth internal control review of a function relates to the level of risk determined by the risk assessment. Functions identified as more vulnerable could be candidates for a more formal internal control review regardless of whether the risk assessment identified any internal control weaknesses. The Corporate Accountant's internal control review process includes the completion of internal control narratives and matrixes, staff interviews, analysis of policies and procedures, observations of functions and operations, and testing of controls currently in place to determine adequacy and effectiveness.

Included in our Internal Controls over Financial Reporting policy, we have established eight pre-defined areas considered to be of high risk and, as such, should be reviewed annually as part of the internal

control program by the Finance Department over the course of the year. These areas include treasury-investment, general ledger-management reporting, accounts receivable-revenue, purchasing-payables, payroll-benefits, inventory costing, taxes and property, plant and equipment.

The classification of internal control failures consists of two tiers:

Major Deficiency – A deficiency, or combination of deficiencies, that is severe enough to adversely affect the likelihood an entity can achieve its objectives.

Internal Control Deficiency – A shortcoming in a relevant principle or component that has the potential to adversely affect the ability of the entity to achieve its objective.

For any deficiency identified during the review process, the respective department manager is notified and must submit a corrective action plan to the Corporate Accountant and Chief Financial Officer along with a timeframe for resolution. The Corporate Accountant and Chief Financial Officer will present any such findings at the quarterly internal control review meetings with executive management. The Chief Financial Officer will present such findings to the audit committee and external auditors during the quarterly review process of the audit committee. The audit committee reviews and approves the adequacy of remediation measures and progress reports. At the direction of the audit committee, the Company will use follow-up measures to ensure corrective actions are implemented. The Company monitors implementation of these actions using tools such as excel spreadsheets, Outlook calendar reminders, and email.

To address serious improprieties or illegal acts committed by employees, the Company will engage with legal services or other external third parties in order to understand, document, and report the facts of the alleged matter for evaluation and assessment. If an illegal act or impropriety is confirmed, the employee will be disciplined accordingly, up to and including the Company taking action to terminate the employee, revoke all access privileges, and file formal charges with appropriate authorities. The Office Administrator is required to document the situation and its resolution, analyze the root cause of the breach, and implement any additional remedial steps to avoid any such similar circumstances in the future. Progress reports are forwarded to the audit committee.

Reporting Compliance Concerns and Fraud

We are all responsible for creating and maintaining a compliance-conscious environment. This includes asking questions if you're not sure what to do and raising concerns if you see something you don't think is right. Early recognition of a problem can prevent something small from becoming big. Reports of violations come from a variety of sources, including employees, managers, our anonymous hotline and external parties. Responses range from no action (if the violation is shown not to have occurred) to various levels of discipline, including dismissal.

Please report your concerns to one of the following:

- A member of executive management or
- Anonymous fraud hotline 1-800-826-6762 (# is also on our internal telephone directory)

Summary

Internal controls are a part of our daily operations. The controls developed and exercised by managers and their staff is the substance of the internal control program. Continued related training and testing helps to ensure that the controls are properly documented and functioning as intended.

As available resources decline, the need for adequate internal control is more important than ever. Fewer people are doing more work with less time and less funding. Opportunities for fraud, waste, and abuse increase significantly in a weak internal control environment. The single most important success factor of the internal control program is a high level of individual awareness and understanding. Internal controls are everyone's responsibility; therefore we are all responsible for knowing what internal controls exist and how to evaluate their effectiveness. A successful internal control program will help streamline our processes and improve the quality of our services.