

FOLLOW-UP REPORT

PetroPro Engineering Inc. Contract

Denver International Airport

November 2019

**Office of the Auditor
Audit Services Division
City and County of Denver**



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AUDITOR'S LETTER

In keeping with generally accepted government auditing standards and Auditor's Office policy, as authorized by city ordinance, the Audit Services Division has a responsibility to monitor and follow up on examination recommendations to ensure findings are addressed through appropriate corrective action and to aid us in planning future audits.

In our follow-up effort for the PetroPro Engineering Inc. contract examination, conducted by CliftonLarsonAllen LLP and issued March 15, 2018, we determined Denver International Airport fully implemented all recommendations made in the examination report.

This report includes a detailed implementation status update for each recommendation.

I would like to express our sincere appreciation to the Denver International Airport personnel who assisted us throughout the examination and the follow-up process. For any questions, please feel free to contact me at 720-913-5000.

Denver Auditor's Office

A handwritten signature in black ink, appearing to read "Timothy M. O'Brien".

Timothy M. O'Brien, CPA
Auditor

RECOMMENDATION — STATUS OF IMPLEMENTATION

FINDING 1 – Document Retention Policy Not Followed for Request for Qualifications No. 201524898

Recommendation

- 1 We recommend that DEN enhance the internal controls surrounding documentation retention to ensure compliance with policies. This can be accomplished by improving checklists and process flows surrounding documentation retention to ensure all documents are kept in accordance with policies.

Status: Implemented (Original target date for completion: Oct. 16, 2017)

Agency Action

Denver International Airport's Contract Services Division implemented a peer review audit and checklist to ensure necessary supporting documents are retained in the project folder. In addition, the airport updated the "DEN Finance Contract Services General Procurement Guidelines" to include the checklist completion requirements.

We obtained a list of contracts for the second, third, and fourth quarters of 2018 and the first quarter of 2019 and selected a sample to review the peer review checklist for completion and appropriate reviewer signatures. Of 70 contracts, we reviewed a sample of seven (10%) peer review checklists and found the checklists were complete and contained the appropriate signatures.

RECOMMENDATION — STATUS OF IMPLEMENTATION

FINDING 2 – Accounting and Reconciliation Activities for Royalty Revenue Not Performed Timely

Recommendation

- 2 We recommend that DEN enhance the internal controls surrounding timely reconciling of its royalty revenues related to its oil and gas wells. This can be accomplished by fully implementing the new accounting system, Workday, so that timely recording and reconciling of this activity can take place.

Status: Implemented (Original target date for completion: April 30, 2018)

Agency Action

As of April 2018, Denver International Airport's Finance Division updated existing standard operating procedures to include:

- Reporting and recording of oil and gas revenues into the city's accounting system, Workday;
- Recognizing revenue on the 30th of the month for previous month activities; and
- The responsible parties for task completion.

The department provided a third-party oil and gas revenue activity report from May 2018, generated from the airport's PROPworks system, which is integrated into Workday. The third-party reports are sent to a centralized email account that users from both the Finance and Revenue Management divisions access.

RECOMMENDATION — STATUS OF IMPLEMENTATION

FINDING 3 – Denver International Airport's Oil and Gas Well Operations Do Not Provide the Best Value to the City and County of Denver

Recommendation

- 3 Based on the observations noted [in the original report related to the lease operating expenses], DEN should enhance its analysis of total costs incurred in operating the oil and gas wells on an ongoing basis to determine if there is a business case to keep operating in this manner. The net revenue earned on the selling of oil and gas well production less operating expenses incurred could be considered excessive and should be further analyzed to determine if it is a good use of DEN's resources to continue operations.

Status: Implemented (Original target date for completion: May 15, 2018)

Agency Action

Denver International Airport's Revenue Management Division hired the University of Wyoming's College of Business, who subcontracted with the Enhance Oil Recovery Institute, to conduct a feasibility study of the airport's oil and gas program to assist in developing short- and long-term strategies. However, shortly after conducting the feasibility study, the oil company managing the wells closed the gathering line—shutting down well production.

The University of Wyoming evaluated production, engineering, and economic performance of the airport's oil and gas program operation. The report provided recommendations for improvement such as defining the capital budget criteria, conducting periodic well tests, defining how lease operating expenses should be collected and stored, improving data management and documentation of the program, and negotiating more flexible terms with PetroPro to reduce the rate on wells that are shut-in.

Although well production halted, the airport used the university's financial model to review the financial feasibility of each well or battery to identify potentially uneconomic wells that would not be reconnected should oil operations resume. The airport will update the feasibility of each well or battery when an oil and gas capital project is requested. The airport said flow tests will be conducted by a third party when wells are back in production.

The airport determined intermittent lease operating expenses will be included with any review of the financial feasibility of a well or battery. However, the airport is waiting on clarification of the impact of Senate Bill 181 to determine how regulatory lease operating expenses will be handled. The Colorado Senate passed Senate Bill 181 in April 2019 to ensure oil and gas development and operations in Colorado are regulated to protect public health, safety, welfare, the environment, and wildlife resources.

The airport also made strides to improve its data and file management program. The airport conducted a review of documents available online, such as land plats on the Colorado Oil and Gas Conservation

Commission website, and in hard copy, such as oil rig service tickets and historic seismic and geologic reports. The airport also revised its in-house electronic filing system and began keeping all required web filings electronically. For example, the Colorado Oil and Gas Conservation Commission requires a web filing when a well changes status to shut-in. Finally, the airport identified gaps and inconsistencies related to documentation retention in its current well file system and is working to determine what documents may be necessary to retain in hard-copy form or whether online copies are sufficient.

With the PetroPro contract expiring in 2021, the airport compiled a list of contract items to include with the new request for proposals, such as clearer well status definitions, potential additions to resolve the incentive conflict noted in the original report, and enhanced data management and reporting expectations. In the meantime, the airport negotiated reduced management and operating fees for the inactive wells waiting permanent plugging.

Recommendation

- 4 Regarding the 17 negative cash flow tank batteries (26 wells), DEN should have a well-by-well review with PetroPro of the 20 wells in question with negative cash flows that are not shut-in or temporarily abandoned. This can help determine if they should be shut-in given the decline curves observed on these 20 wells that are included in the negative cash flow tank batteries.

Status: Implemented (Original target date for completion: May 15, 2018)

Agency Action

PetroPro conducted an analysis of the wells and updated the status of uneconomic wells in July 2019. The airport also conducted a curve analysis using the University of Wyoming's model to provide data on economic and uneconomic wells. Both resulted in multiple wells and batteries that are economical and uneconomical to continue production if the airport decides to reconnect.

PetroPro conducted an annual cash flow report for each well, detailing the gross and net production for years 2019 through 2033. The airport will use these resources if and when the decision is made to reconnect the wells.

CONCLUSION

We found Denver International Airport has fully implemented all recommendations and adequately mitigated the risks identified during the original examination. As a result, we conclude our follow-up effort related to the PetroPro Engineering Inc. contract examination.

On behalf of the citizens of the City and County of Denver, we thank staff and leadership from Denver International Airport's Finance and Revenue Management divisions for their cooperation during our follow-up effort and for their dedicated public service.

Office of the Auditor

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