

Citadel Exploration, Inc.
Form 10-K
April 01, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 2012

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

Commission file number 000-54639

CITADEL EXPLORATION, INC.
(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of incorporation or
organization)

27-1550482
(I.R.S. Employer Identification No.)

417 31st Street, Unit A
Newport Beach, California 92663
(Address of principal executive offices) (Zip Code)

(949) 612-8040
(Registrant's telephone number, including area code)

Copies of Communications to:
Rutan & Tucker
611 Anton Blvd, 14th Floor Newport Beach, CA 92663
(714) 641-3487 • Fax (714) 546-9035

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock, \$0.001 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

Edgar Filing: Citadel Exploration, Inc. - Form 10-K

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "small reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act). Yes No

The aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of June 30, 2012 (the last business day of the registrant's most recently completed second fiscal quarter) was \$13,567,800 based on a share value of \$0.60.

The number of shares of Common Stock, \$0.001 par value, outstanding on April 1, 2013 was 28,031,640 shares.

DOCUMENTS INCORPORATED BY REFERENCE: None.

CITADEL EXPLORATION, INC.
FOR THE FISCAL YEAR ENDED
DECEMBER 31, 2012

Index to Report
on Form 10-K

		Page
PART I		
Item 1.	Business	2
Item 1A.	Risk Factors	9
Item 1B.	Unresolved Staff Comments	16
Item 2.	Properties	2
Item 3.	Legal Proceedings	16
PART II		
Item 5.	Market for Registrant's Common Equity and Related Stockholder Matters and Issuer Purchases of Equity Securities	16
Item 6.	Selected Financial Data	18
Item 7.	Management's Discussion and Analysis of Financial Condition and Results of Operations	18
Item 7A.	Quantitative and Qualitative Disclosures About Market Risk	22
Item 8.	Financial Statements and Supplementary Data	22
Item 9.	Changes in and Disagreements With Accountants on Accounting and Financial Disclosure	22
Item 9A (T)	Control and Procedures	22
Item 9B.	Other Information	23
PART III		
Item 10.	Directors, Executive Officers and Corporate Governance	23
Item 11.	Executive Compensation	27
Item 12.	Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters	28
Item 13.	Certain Relationships and Related Transactions, and Director Independence	29
Item 14	Principal Accounting Fees and Services	30
PART IV		
Item 15.	Exhibits, Financial Statement Schedules	31

FORWARD-LOOKING STATEMENTS

This Annual Report on Form 10-K contains forward-looking statements and involves risks and uncertainties that could materially affect expected results of operations, liquidity, cash flows, and business prospects. These statements include, among other things, statements regarding:

- o our ability to diversify our operations;
- o exploration risks such as drilling unsuccessful wells;
- o our ability to attract key personnel;
- o our ability to operate profitably;
- o our ability to efficiently and effectively finance our operations, and/or purchase orders;
- o inability to achieve future sales levels or other operating results;
- o inability to raise additional financing for working capital;
- o inability to efficiently manage our operations;
- o the inability of management to effectively implement our strategies and business plans;
- o the unavailability of funds for capital expenditures and/or general working capital;
- o the fact that our accounting policies and methods are fundamental to how we report our financial condition and results of operations, and they may require management to make estimates about matters that are inherently uncertain;
- o deterioration in general or regional economic conditions;
- o changes in U.S. GAAP or in the legal, regulatory and legislative environments in the markets in which we operate;
- o adverse state or federal legislation or regulation that increases the costs of compliance, or adverse findings by a regulator with respect to existing operations;

as well as other statements regarding our future operations, financial condition and prospects, and business strategies. Forward-looking statements may appear throughout this report, including without limitation, the following sections: Item 1 “Business,” Item 1A “Risk Factors,” and Item 7 “Management’s Discussion and Analysis of Financial Condition and Results of Operations.” Forward-looking statements generally can be identified by words such as “anticipates,” “believes,” “estimates,” “expects,” “intends,” “plans,” “predicts,” “projects,” “will be,” “will continue,” “will likely result,” and similar terms. These forward-looking statements are based on current expectations and assumptions that are subject to risks and uncertainties, which could cause our actual results to differ materially from those reflected in the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those discussed in this Annual Report on Form 10-K, and in particular, the risks discussed under the caption “Risk Factors” in Item 1A and those discussed in other documents we file with the Securities and Exchange Commission (SEC). We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements, except as required by law. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such

forward-looking statements.

1

Throughout this Annual Report references to “we”, “our”, “us”, “Citadel”, “COIL”, “the Company”, and similar terms include Citadel Exploration, Inc. and its subsidiaries, unless the context indicates otherwise.

AVAILABLE INFORMATION

We file annual, quarterly and other reports and other information with the SEC. You can read these SEC filings and reports over the Internet at the SEC’s website at www.sec.gov or on our website at www.citadelexploration.com. You can also obtain copies of the documents at prescribed rates by writing to the Public Reference Section of the SEC at 100 F Street, NE, Washington, DC 20549 on official business days between the hours of 10:00 am and 3:00 pm. Please call the SEC at (800) SEC-0330 for further information on the operations of the public reference facilities. We will provide a copy of our annual report to security holders, including audited financial statements, at no charge upon receipt to of a written request to us at Citadel Exploration, Inc., 417 31st Street Unit A, Newport Beach, California 92663.

INDUSTRY AND MARKET DATA

The market data and certain other statistical information used throughout this report are based on independent industry publications, government publications, reports by market research firms or other published independent sources. In addition, some data are based on our good faith estimates.

PART I

ITEM 1. BUSINESS AND 2. PROPERTIES

Business Development

Citadel Exploration, Inc. (“Citadel”) was formed as a Nevada corporation in December 2009. On March 2, 2011, Citadel changed its name from Subprime Advantage, Inc. to Citadel Exploration, Inc. Effective May 3, 2011, Citadel completed the acquisition of the Indian Shallow Oil Development Project, located in the Bitterwater sub-basin of the Salinas Basin in California, consisting of 689 acres of leased property from Vintage Petroleum, LLC (Vintage), a division of Occidental Petroleum (NYSE: OXY), through the acquisition of 100% of the outstanding membership interest of Citadel Exploration, LLC, a California Limited Liability Company (“CEL”) pursuant to the Membership Purchase Agreement and Plan of Reorganization (“Membership Purchase Agreement”).

As a result of the closing of the Membership Purchase Agreement, Citadel is an oil and gas exploration company with operations in the Salinas Basin of California. As a result of our recent acquisition of CEL, we will have a broad portfolio of capital investment opportunities that arise from CEL’s extensive knowledge of the geology and the history of oil and gas exploration and development in California as well as long-term presence and familiarity and relationships with other companies engaged in oil and gas industry in California.

Business of Citadel

We are an exploration company engaged in the exploration and development of oil and natural gas properties. Our property is located in the County of San Benito, California. Subject to availability of capital, we strive to implement an accelerated development program utilizing capital resources, a regional operating focus, an experienced management and technical team, and enhanced recovery technologies to attempt to increase production and increase returns for our stockholders. Our corporate strategy is to continue building value in the Company through successful exploration and development of gas and oil assets.

Our Projects

Citadel is in advanced discussions to participate with Black Hawk Oil Co. LLC (Blackhawk) and Sojitz Energy Ventures (Sojitz) in the South San Joaquin Valley. Sojitz and Blackhawk have collectively leased over 52,000 acres in the area under the guidance of The Nahabedian Exploration Group LLC. Subject to adequate financing and on a prospect by prospect basis Citadel will be able to farm-in on that lease block under favorable terms. Citadel has already identified more than 15 prospects on the lease block for drilling.

On January 31, 2009, our wholly-owned subsidiary, CEL, entered into an Oil and Gas Lease (“Lease”) for 689 acres of property with Vintage, a company owned by Occidental Petroleum (NYSE:OXY), for an initial term of three years. During February 2012, we entered into a new lease with Vintage for a period of two years.

Other Events

On February 22, 2012, we executed a “Letter Agreement Sale of Partial Interest in Vintage Lease, Project Indian” (“Vintage Lease Agreement”) with Sojitz Energy Venture, Inc. (“Sojitz”), whereby we sold to Sojitz an undivided Forty percent (40%) interest (“Assigned Interest”) relating to the Oil, Gas, and Mineral Lease dated February 1, 2012 from Vintage Petroleum California, LLC (the “Lessor”), a Delaware Limited Liability Company and wholly owned subsidiary of Occidental Petroleum, to Citadel, as Lessee. The Vintage Lease Agreement relates to a property known as “Project Indian,” which is located in San Benito County, California, covering approximately 689 acres of land, for a term of Five (5) years. As consideration for the Assigned Interest, Sojitz paid Citadel the sum of Three Hundred and Fifty Thousand Dollars (\$350,000). Additionally, as part of the Vintage Lease Agreement, the parties entered into a Joint Operating Agreement (“JOA”), which includes all area under the Lease, as well as an area designated as Area of Mutual Interest or “AMI”.

SOJITZ JOINT VENTURE / RANCHO GRANDE

Rancho Grande was acquired by Sojitz Energy Venture Inc and Black Hawk Oil Co. LLC in August 2011. The lease covers more than 52,000 acres and is part of the largest, privately held, contiguous acreage block in the state of California. The lands have a total royalty burden of 23% and over 15 prospects have already been identified by Citadel for drilling. Citadel will have the option to participate on a prospect by prospect basis on industry standard terms. Prospect areas will be defined in advance of the drilling of an exploratory well and the amounts of acreage earned will be determined by the depth of completion. This acreage block is highly prospective and permitting efforts have commenced on the block. Wells may be drilled in the second quarter of 2013 in areas that are within existing administrative field boundaries. From the recent work conducted on the block utilizing 2D /3D seismic, well control, offset production figures, and other available information, Citadel believes there is a strong chance for as much as 100 million gross barrels of recoverable oil from this block. Targets on this block range in depth from 1000’ to 15,000’ and range from heavy oil to gas condensate.

PROJECT INDIAN

Project Indian is located in the Bitterwater sub-basin of the Salinas Basin, north of the giant San Ardo Field. It is a shallow anticline defined by surface geology and well control that may have over 100 million barrels of heavy (11-14 gravity API) oil in place. A well that was drilled and cored extensively by Chevron in 1976 (Tannehill Ranch Corehole #9) showed the oil is trapped in highly porous and permeable basal Pliocene sands at 300-500 feet deep with 300' of claystone cap rock. This accumulation is a strong analog to another discovery made by the founders of CEL at Northwest San Ardo, albeit at a shallower depth.

We will develop Project Indian as a thermal recovery operation. The initial phase of evaluation will entail the drilling of 15 vertical wells and cyclic steaming to initiate production. Full scale development may follow in 2015 following the analysis of steaming and production of vertical wells. Record high long term oil prices make a target of this size extremely attractive.

Development Plan

The project will include the drilling of 15 wells to collect data on the subsurface reservoir. This data will be used to determine which wells are suitable candidates for a pilot thermal enhanced recovery program. Temporary equipment will be used to conduct a pilot thermal enhanced recovery program. The pilot recovery program will provide data that will help determine economic viability and potential future development of the subsurface reservoir. Highlights of this project include: 1) drilling and coring, 2) collecting and analyzing the data, 3) installation of temporary production facilities, 4) pilot steam injection and saturation, 5) well production test, and 6) collecting production and steam injection data and analyzing.

Upon successful completion of the pilot program testing we will begin the next phase of development. This includes installation of a natural gas utility line and electric power. We have already confirmed with Pacific Gas and Electric that utility gas and power are available within 2 miles of the project site. Temporary equipment will be utilized for initial operations and additional permanent equipment will be installed at a later date. All wells will then be placed in service and additional drilling will begin.

Royalties

On oil and other liquid hydrocarbons produced from each well located on the leased premises, the royalties shall be the market value of nineteen and one-half percent (19.5%) to be paid to Vintage and one-half of one percent (1/2 of 1%) to Pacific Minerals LLC (PML), a California limited liability company (pursuant to a non-executory royalty interest owned by PML) of that produced, saved or used from such well, the same to be delivered at such well or to the credit of Vintage, free of all costs of production or delivery into the pipeline to which the wells may be connected. If Vintage does not take such oil in kind, CEL shall market such oil at its market value, and the royalties payable shall be computed on such market value. If such oil is marketed by CEL, "market value" shall mean the proceeds received by CEL in an arms-length, good faith transaction with a third party purchaser, who is not a subsidiary or affiliate of CEL.

On gas, including casing head gas or other gaseous substances, produced from each well located on the leased premises, the royalties shall be the market value of nineteen and one-half percent (19.5%) to Vintage and one-half percent (1/2 of 1%) to PML (pursuant to a non-executory royalty interest owned by PML) of the gas produced, used, vented or flared from such well (excepting any gas flared or vented during a reasonable test period), delivered to Vintage, free of all costs of production and delivery. Vintage may, with prior written consent, use, vent or flare, royalty free any gas produced from the well or wells located on the lease premises for operations conducted on the lease premises. If Vintage does not take such gas in kind, CEL shall market such gas at its market value, and the

royalties payable shall be computed on such market value. With respect to gas sold by CEL the term “market value” shall mean the proceeds received by CEL in an arms-length, good faith transaction with a third party purchaser. If CEL sells gas in good faith to a third party who is not a subsidiary or an affiliate of CEL, and the gas is sold at a point off the leased premises, Vintage’s royalty shall bear its pro rata share of reasonable transportation costs to such point of sale. Without the prior written consent of Vintage, CEL shall not (i) sell gas to any subsidiary or affiliate of CEL for transportation, gathering or treating of gas in a Hydrocarbon Recovery Plan, in the event transportation is chargeable against Vintage’s interest, as provided for above.

Oil and Natural Gas Industry Overview

Oil and natural gas prices are currently at high levels. Based on worldwide supply and demand projections and the potential for instability in areas that currently provide a large proportion of the world’s petroleum, we believe that prices are likely to remain at high levels for the foreseeable future. We believe that this presents a tremendous opportunity for our Company to grow quickly. We have assembled an experienced and senior team of professionals to evaluate, acquire and manage available prospects. The experience of this team and its ability to quickly and accurately evaluate prospects and subsequently apply modern exploration, development and production techniques should be key to our company’s success. A number of factors, including high product prices, the ease and availability of capital, and the influx of that capital into the oil and natural gas sector has resulted in tremendous competition for prospects, people, equipment and services in recent years. We believe that our planned ability to quickly and accurately assess opportunities worth pursuing, to negotiate the best possible terms and to attract the people, equipment and services required to finance and effect the projects should constitute a competitive advantage. Our goal is to grow our Company and increase stockholder value in a favorable petroleum pricing environment. We believe a focus on oil and gas will result in success and growth through added reserves and cash flow which will, in turn, provide a base for further growth and increases in stockholder value.

Our Business Strategy

Our principal strategy has been to focus on the acquisition and drilling of prospective oil and natural gas mineral leases. Once we have tested a prospect as productive, subject to availability of capital, we will implement a development program with a regional operating focus in order to increase production and increase returns for our stockholders. Exploration, acquisition and development activities are currently focused in California. Depending on availability of capital, and other constraints, our goal is to increase stockholder value by finding and developing oil and natural gas reserves at costs that provide an attractive rate of return on our investments. The principal elements of our business strategy are:

- **Develop Our Existing Property.** We intend to create reserve and production growth from our drilling locations we have identified on our property. The expected ultimate recovery and production rates of our properties, are anticipated to yield long-term profitability.
- **Maximize Operational Control.** We seek to operate our properties and maintain a substantial working interest. We believe the ability to control our drilling inventory will provide us with the opportunity to more efficiently allocate capital, manage resources, control operating and development costs, and utilize our experience and knowledge of oilfield technologies.

- Pursue Selective Acquisitions and Joint Ventures. We believe we are well-positioned to pursue selected acquisitions, subject to availability of capital, from the fragmented and capital-constrained owners of mineral rights throughout California.
- Reduce Unit Costs Through Economies of Scale and Efficient Operations. As we increase our oil production and develop our existing property, we expect that our unit cost structure will benefit from economies of scale. In particular, we anticipate reducing unit costs by greater utilization of our existing infrastructure over a larger number of wells.

We are continually evaluating oil and natural gas opportunities in California and are also in various stages of discussions with potential joint venture (“JV”) partners who may contribute capital to develop leases we currently own or would acquire for the JV. This economic strategy is anticipated to allow us to utilize our own financial assets toward the growth of our leased acreage holdings, pursue the acquisition of strategic oil and natural gas producing properties or companies and generally expand our existing operations while further diversifying risk. Subject to availability of capital, we plan to continue to bring potential acquisition and JV opportunities to various financial partners for evaluation and funding options.

Our future financial results will continue to depend on: (i) our ability to source and screen potential projects; (ii) our ability to discover commercial quantities of natural gas and oil; (iii) the market price for oil and natural gas; and (iv) our ability to fully implement our exploration, work-over and development program, which is in part dependent on the availability of capital resources. There can be no assurance that we will be successful in any of these respects, that the prices of oil and natural gas prevailing at the time of production will be at a level allowing for profitable production, or that we will be able to obtain additional funding at terms favorable to us to increase our currently limited capital resources. For a detailed description of these and other factors that could materially impact actual results, please see “Risk Factors” in this report.

Competition

The oil and natural gas industry is intensely competitive. We compete with numerous individuals and companies, including many major oil and natural gas companies, which have substantially greater technical, financial and operational resources and staff. Accordingly, there is a high degree of competition for desirable oil and natural gas leases, suitable properties for drilling operations and necessary drilling equipment, as well as for access to funds.

Governmental Regulations

Regulation of Oil and Natural Gas Production. Our oil and natural gas exploration, production and related operations, when developed, are subject to extensive rules and regulations promulgated by federal, state, tribal and local authorities and agencies. For example, some states in which we may operate, including California, require permits for drilling operations, drilling bonds and reports concerning operations and impose other requirements relating to the exploration and production of oil and natural gas. Such states may also have statutes or regulations addressing conservation matters, including provisions for the unitization or pooling of oil and natural gas properties, the establishment of maximum rates of production from wells, and the regulation of spacing, plugging and abandonment of such wells. Failure to comply with any such rules and regulations can result in substantial penalties. Moreover, such states may place burdens from previous operations on current lease owners, and the burdens could be significant. The regulatory burden on the oil and natural gas industry will most likely increase our cost of doing business and may affect our profitability. Although we believe we are currently in substantial compliance with all applicable laws and regulations, because such rules and regulations are frequently amended or reinterpreted, we are unable to predict the

future cost or impact of complying with such laws. Significant expenditures may be required to comply with governmental laws and regulations and may have a material adverse effect on our financial condition and results of operations.

Federal Regulation of Natural Gas. The Federal Energy Regulatory Commission (“FERC”) regulates interstate natural gas transportation rates and service conditions, which may affect the marketing of natural gas produced by us, as well as the revenues that may be received by us for sales of such production. Since the mid-1980’s, FERC has issued a series of orders, culminating in Order Nos. 636, 636-A and 636-B (“Order 636”), that have significantly altered the marketing and transportation of natural gas. Order 636 mandated a fundamental restructuring of interstate pipeline sales and transportation service, including the unbundling by interstate pipelines of the sale, transportation, storage and other components of the city-gate sales services such pipelines previously performed. One of FERC’s purposes in issuing the order was to increase competition within all phases of the natural gas industry. The United States Court of Appeals for the District of Columbia Circuit largely upheld Order 636 and the Supreme Court has declined to hear the appeal from that decision. Generally, Order 636 has eliminated or substantially reduced the interstate pipelines’ traditional role as wholesalers of natural gas in favor of providing only storage and transportation service, and has substantially increased competition and volatility in natural gas markets.

The price we may receive from the sale of oil and natural gas liquids will be affected by the cost of transporting products to markets. Effective September 28, 1995, FERC implemented regulations establishing an indexing system for transportation rates for oil pipelines, which, generally, would index such rates to inflation, subject to certain conditions and limitations. We are not able to predict with certainty the effect, if any, of these regulations on our intended operations. However, the regulations may increase transportation costs or reduce well head prices for oil and natural gas liquids.

Environmental Matters

Our operations and properties are subject to extensive and changing federal, state and local laws and regulations relating to environmental protection, including the generation, storage, handling, emission, transportation and discharge of materials into the environment, and relating to safety and health. The recent trend in environmental legislation and regulation generally is toward stricter standards, and this trend will likely continue.

These laws and regulations may:

- require the acquisition of a permit or other authorization before construction or drilling commences and for certain other activities;
- limit or prohibit construction, drilling and other activities on certain lands lying within wilderness and other protected areas; and
- impose substantial liabilities for pollution resulting from its operations, or due to previous operations conducted on any leased lands.

The permits required for our operations may be subject to revocation, modification and renewal by issuing authorities. Governmental authorities have the power to enforce their regulations, and violations are subject to fines or injunctions, or both. In the opinion of management, we are in substantial compliance with current applicable environmental laws and regulations, and have no material commitments for capital expenditures to comply with existing environmental requirements. Nevertheless, changes in existing environmental laws and regulations or in interpretations thereof could have a significant impact on us, as well as the oil and natural gas industry in general.

The Comprehensive Environmental, Response, Compensation, and Liability Act, as amended (“CERCLA”), and comparable state statutes impose strict, joint and several liability on owners and operators of sites and on persons who disposed of or arranged for the disposal of “hazardous substances” found at such sites. It is not uncommon for the neighboring land owners and other third parties to file claims for personal injury and property damage allegedly caused by the hazardous substances released into the environment. The Federal Resource Conservation and Recovery Act, as amended (“RCRA”), and comparable state statutes govern the disposal of “solid waste” and “hazardous waste” and authorize the imposition of substantial fines and penalties for noncompliance. Although CERCLA currently excludes petroleum from its definition of “hazardous substance,” state laws affecting our operations may impose clean-up liability relating to petroleum and petroleum related products. In addition, although RCRA classifies certain oil field wastes as “non-hazardous,” such exploration and production wastes could be reclassified as hazardous wastes thereby making such wastes subject to more stringent handling and disposal requirements.

The Federal Water Pollution Control Act of 1972, as amended (“Clean Water Act”), and analogous state laws impose restrictions and controls on the discharge of pollutants into federal and state waters. These laws also regulate the discharge of storm water in process areas. Pursuant to these laws and regulations, we are required to obtain and maintain approvals or permits for the discharge of wastewater and storm water and develop and implement spill prevention, control and countermeasure plans, also referred to as “SPCC plans,” in connection with on-site storage of greater than threshold quantities of oil. The EPA issued revised SPCC rules in July 2002 whereby SPCC plans are subject to more rigorous review and certification procedures. We believe that our operations are in substantial compliance with applicable Clean Water Act and analogous state requirements, including those relating to wastewater and storm water discharges and SPCC plans.

The Endangered Species Act, as amended (“ESA”), seeks to ensure that activities do not jeopardize endangered or threatened animal, fish and plant species, nor destroy or modify the critical habitat of such species. Under ESA, exploration and production operations, as well as actions by federal agencies, may not significantly impair or jeopardize the species or its habitat. ESA provides for criminal penalties for willful violations of the Act. Other statutes that provide protection to animal and plant species and that may apply to our operations include, but are not necessarily limited to, the Fish and Wildlife Coordination Act, the Fishery Conservation and Management Act, the Migratory Bird Treaty Act and the National Historic Preservation Act. Although we believe that our operations will be in substantial compliance with such statutes, any change in these statutes or any reclassification of a species as endangered could subject us to significant expenses to modify our operations or could force us to discontinue certain operations altogether.

Personnel

As of the date of this report, and as a result of our recent organizational establishment, we had two full-time employees. As production and drilling activities increase or decrease, we may have to adjust our technical, operational and administrative personnel as appropriate. We are using and will continue to use independent consultants and contractors to perform various professional services, particularly in the area of land services, reservoir engineering, geology drilling, water hauling, pipeline construction, well design, well-site monitoring and surveillance, permitting and environmental assessment. We believe that this use of third-party service providers may enhance our ability to contain operating and general expenses, and capital costs.

Glossary of Terms

Term	Definition
API Gravity	Is a measure of how heavy or light a petroleum liquid is compared to water. If its API gravity is greater than 10, it is lighter and floats on water; if less than 10, it is heavier and sinks.
Barrel	In the energy industry, a barrel is a unit of volume measurement used for petroleum and is equivalent to 42 U.S. gallons measured at 60 ° Fahrenheit.
Basin	A depressed area where sediments have accumulated during geologic time and considered to be prospective for oil and gas deposits.
Blowout	An uncontrolled flow of oil, gas, water or mud from a wellbore caused when drilling activity penetrates a rock layer with natural pressures greater than the drilling mud in the borehole.
Completion / Completing	A well made ready to produce oil or natural gas. Completion involves cleaning out the well, running and cementing steel casing in the hole, adding permanent surface control equipment, and perforating the casing so oil or gas can flow into the well and be brought to the surface.
Desorb	The release of materials (e.g., gas molecules) from being adsorbed onto a surface. The opposite of adsorb.
Development	The phase in which a proven oil or gas field is brought into production by drilling production (development) wells.
Division order	A contract for the sale of oil or gas, by the holder of a revenue interest in a well or property, to the purchaser (often a pipeline transmission company).
Drilling	The using of a rig and crew for the drilling, suspension, production testing, capping, plugging and abandoning, deepening, plugging back, sidetracking, re-drilling or reconditioning of a well. Contrast to "Completion" definition.
Drilling logs	Recorded observations made of rock chips cut from the formation by the drill bit, and brought to the surface with the mud, as well as rate of penetration of the drill bit through rock formations. Used by geologists to obtain formation data.
Exploration	The phase of operations which covers the search for oil or gas by carrying out detailed geological and geophysical surveys followed up where appropriate by exploratory drilling. Compare to "Development" phase.
Farm out	Assignment or partial assignment of an oil and gas lease from one lessee to another lessee.

Edgar Filing: Citadel Exploration, Inc. - Form 10-K

Gathering line / system	A pipeline that transports oil or gas from a central point of production to a transmission line or mainline.
Gross acre	An acre in which a working interest is owned. The number of gross acres is the total number of acres in which a working interest is owned.
Gross well	A well in which a working interest is owned. The number of gross wells is the total number of wells in which a working interest is owned.
Held-By-Production (HBP)	Refers to an oil and gas property under lease, in which the lease continues to be in force, because of production from the property.
Land services	Services performed by an oil and gas company or agent, or landman, who negotiates oil and gas leases with mineral owners, cures title defects, and negotiates with other companies on agreements concerning the lease.
Logging (electric logging)	Process of lowering sensors into a wellbore to acquire downhole recordings that indicate a well's rock formation characteristics and indications of hydrocarbons.
Methane	An organic chemical compound of hydrogen and carbon (i.e., hydrocarbon), with the simplest molecular structure (CH ₄).
Mineral Lease	A legal instrument executed by a mineral owner granting exclusive right to another to explore, drill, and produce oil and gas from a piece of land.
Natural gas quality	The value of natural gas is calculated by its BTU content. A cubic foot of natural gas on the average gives off 1000 BTU, but the range of values is between 500 and 1500 BTU. Energy content of natural gas is variable and depends on its accumulations which are influenced by the amount and types of energy gases they contain: the more non-combustible gases in a natural gas, the lower the Btu value.
Net acre	A net acre is deemed to exist when the sum of fractional working interests owned in gross acres equals one. The number of net acres is the sum of fractional working interests owned in gross acres expressed as whole numbers and fractions thereof.
Net well	A net well is deemed to exist when the sum of fractional working interests owned in gross wells equals one. The number of net wells is the sum of fractional working interests owned in gross wells expressed as whole numbers and fractions thereof.
Operator	A person, acting for himself or as an agent for others and designated to the state authorities as the one who has the primary responsibility for complying with its rules and regulations in any and all acts subject to the jurisdiction of the state.
Permeability	The property of a rock formation which quantifies the flow of a fluid through the pore spaces and into the wellbore.

Pooled, Pooled Unit	A term frequently used interchangeably with "Unitization" but more properly used to denominate the bringing together of small tracts sufficient for the granting of a well permit under applicable spacing rules.
Proved Reserves	<p>Estimated quantities of crude oil, natural gas, condensate, or other hydrocarbons that geological and engineering data demonstrate with reasonable certainty to be commercially recoverable in the future from known reservoirs under existing conditions using established operating procedures and under current governmental regulations.</p> <p>Further definitions of oil and gas reserves, as defined by the SEC, can be found in Rule 4-10(a)(2)(i)-(iii) and Rule 4-10(a)(3) and (4). These Rules are available at the SEC's website; http://www.sec.gov/divisions/corpfin/forms/regsx.htm#gas</p>
Re-completion	Completion of an existing well for production from one formation or reservoir to another formation or reservoir that exists behind casing of the same well.
Reserves	Generally the amount of oil or gas in a particular reservoir that is available for production.
Reservoir	The underground rock formation where oil and gas has accumulated. It consists of a porous rock to hold the oil or gas, and a cap rock that prevents its escape.
Reservoir Pressure	The pressure at the face of the producing formation when the well is shut-in. It equals the shut in pressure at the wellhead plus the weight of the column of oil in the hole.
Shut-in well	A well which is capable of producing but is not presently producing. Reasons for a well being shut-in may be lack of equipment, market or other.

Stratigraphic Trap	A variety of sealed geologic containers capable of retaining hydrocarbons, formed by changes in rock type or pinch-outs, unconformities, or sedimentary features.
Structural Trap	A variety of sealed geologic structures capable of retaining hydrocarbons, such as a faults or a folds.
Undeveloped acreage	Leased acreage which has yet to be drilled on to test the potential for hydrocarbons.
Unitize, Unitization	Joint operations to maximize produced hydrocarbon recovery among separate operators within a common reservoir.
Working Interest	The right granted to the lessee of a property to explore for and to produce and own oil, gas, or other minerals. The working interest owners bear the exploration, development, and operating costs on either a cash, penalty, or carried basis.

ITEM 1A. RISK FACTORS

RISKS ASSOCIATED WITH OIL AND GAS OPERATIONS

Drilling wells is speculative, often involving significant costs that may be more than our estimates, and may not result in any addition to our production or reserves. Any material inaccuracies in drilling costs, estimates or underlying assumptions will materially affect our business.

Developing and exploring for natural gas and oil involves a high degree of operational and financial risk, which precludes definitive statements as to the time required and costs involved in reaching certain objectives. The budgeted costs of drilling, completing and operating wells are often exceeded and can increase significantly when drilling costs rise due to a tightening in the supply of various types of oilfield equipment and related services. Drilling may be unsuccessful for many reasons, including title problems, weather, cost overruns, equipment shortages and mechanical difficulties. Moreover, the successful drilling of a natural gas or oil well does not ensure a profit on investment. Exploratory wells bear a much greater risk of loss than development wells. A variety of factors, both geological and market-related, can cause a well to become uneconomical or only marginally economic. Our initial drilling and development sites, and any potential additional sites that may be developed, require significant additional exploration and development, regulatory approval and commitments of resources prior to commercial development. Any success that we may have with these wells or any future drilling operations will most likely not be indicative of our current or future drilling success rate, particularly, because we intend to emphasize on exploratory drilling. If our actual drilling and development costs are significantly more than our estimated costs, we may not be able to continue our business operations as proposed and would be forced to modify our plan of operation.

Development of our reserves, when established, may not occur as scheduled and the actual results may not be as anticipated. Drilling activity may result in downward adjustments in reserves or higher than anticipated costs. Our estimates will be based on various assumptions, including assumptions required by the Securities and Exchange Commission relating to natural gas and oil prices, drilling and operating expenses, capital expenditures, taxes and availability of funds. The process of estimating our natural gas and oil reserves is anticipated to be extremely complex, and will require significant decisions and assumptions in the evaluation of available geological, geophysical,

engineering and economic data for each reservoir. Due to our inexperience in the oil and gas industry, our estimates may not be reliable enough to allow us to be successful in our intended business operations. Our actual production, revenues, taxes, development expenditures and operating expenses will likely vary from those anticipated. These variances may be material.

If we are unable to continue drilling operations pursuant to the terms set forth in our lease agreement with Vintage Petroleum, LLC, the lease agreement may be terminated. If we were to lose the lease our financial condition and results of operations would be adversely affected.

Our lease ownership is subject to termination in the event we are unable to continue drilling operations as set forth in the lease agreement. In the event we are unable to continue with our drilling operations, then we will lose our rights to the lease. Such loss would prevent us from pursuing development activity on the leased property and will have a substantial impact on our financial condition and results of operations.

Gas and Oil prices are volatile. This volatility may occur in the future, causing negative change in cash flows which may result in our inability to cover our capital expenditures.

Our future revenues, profitability, future growth and the carrying value of our properties is anticipated to depend substantially on the prices we may realize for our natural gas and oil production. Our realized prices may also affect the amount of cash flow available for capital expenditures and our ability to borrow and raise additional capital.

Natural gas and oil prices are subject to wide fluctuations in response to relatively minor changes in or perceptions regarding supply and demand. Historically, the markets for natural gas and oil have been volatile, and they are likely to continue to be volatile in the future. For example, natural gas and oil prices declined significantly in late 1998 and 1999 and, for an extended period of time, remained substantially below prices obtained in previous years. Among the factors that can cause this volatility are:

- worldwide or regional demand for energy, which is affected by economic conditions;
- the domestic and foreign supply of natural gas and oil;
- weather conditions;
- domestic and foreign governmental regulations;
- political conditions in natural gas and oil producing regions;
- the ability of members of the Organization of Petroleum Exporting Countries to agree upon and maintain oil prices and production levels; and
- the price and availability of other fuels.

It is impossible to predict natural gas and oil price movements with certainty. Lower natural gas and oil prices may not only decrease our future revenues on a per unit basis but also may reduce the amount of natural gas and oil that we can produce economically. A substantial or extended decline in natural gas and oil prices may materially and adversely affect our future business enough to force us to cease our business operations. In addition, our financial condition, results of operations, liquidity and ability to finance planned capital expenditures will also suffer in such a price decline. Further, natural gas and oil prices do not necessarily move together.

We may incur substantial write-downs of the carrying value of our gas and oil properties, which would adversely impact our earnings.

We periodically review the carrying value of our gas and oil properties under the successful effort method accounting rules of the Securities and Exchange Commission. Under these rules, capitalized costs of proved gas and oil properties may not exceed the present value of estimated future net revenues from proved reserves, discounted at an annual rate of 10%. Application of this “ceiling” test requires pricing future revenue at the un-escalated prices in effect as of the end of each fiscal quarter and requires a write-down for accounting purposes if the ceiling is exceeded, even if prices were depressed for only a short period of time. We may be required to write down the carrying value of our gas and oil properties when natural gas and oil prices are depressed or unusually volatile, which would result in a charge against our earnings. Once incurred, a write-down of the carrying value of our natural gas and oil properties is not reversible at a later date.

Currently the vast majority of our properties are located in the Bitterwater sub-basin of the Salinas Basin in the County of San Benito, California, making us vulnerable to risks associated with having our production concentrated in one area.

The vast majority of our properties are geographically concentrated in the Bitterwater sub-basin of the Salinas Basin in the County of San Benito, California. As a result of this concentration, we may be disproportionately exposed to the impact of delays or interruptions of production from these wells caused by significant governmental regulation, transportation capacity constraints, curtailment of production, natural disasters, adverse weather conditions or interruption of transportation of natural gas produced from the wells in this basin or other events which impact this area.

Competition in our industry is intense. We are very small and have an extremely limited operating history as compared to the vast majority of our competitors, and we may not be able to compete effectively.

We intend to compete with major and independent natural gas and oil companies for property acquisitions. We will also compete for the equipment and labor required to operate and to develop natural gas and oil properties. The majority of our anticipated competitors have substantially greater financial and other resources than we do. In addition, larger competitors may be able to absorb the burden of any changes in federal, state and local laws and regulations more easily than we can, which would adversely affect our competitive position. These competitors may be able to pay more for natural gas and oil properties and may be able to define, evaluate, bid for and acquire a greater number of properties than we can. Our ability to acquire additional properties and develop new and existing properties in the future will depend on our ability to conduct operations, to evaluate and select suitable properties and to consummate transactions in this highly competitive environment. In addition, some of our competitors have been operating in our core areas for a much longer time than we have and have demonstrated the ability to operate through industry cycles.

The natural gas and oil business involves numerous uncertainties and operating risks that can prevent us from realizing profits and can cause substantial losses.

Our development, exploitation and exploration activities may be unsuccessful for many reasons, including weather, cost overruns, equipment shortages and mechanical difficulties. Moreover, the successful drilling of a natural gas and oil well does not ensure a profit on investment. A variety of factors, both geological and market-related, can cause a well to become uneconomical or only marginally economical. In addition to their cost, unsuccessful wells can hurt our efforts to replace reserves.

The natural gas and oil business involves a variety of operating risks, including:

- fires;
- explosions;
- blow-outs and surface cratering;
- uncontrollable flows of oil, natural gas, and formation water;
- natural disasters, such as hurricanes and other adverse weather conditions;
- pipe, cement, or pipeline failures;
- casing collapses;
- embedded oil field drilling and service tools;
- abnormally pressured formations; and
- environmental hazards, such as natural gas leaks, oil spills, pipeline ruptures and discharges of toxic gases.

If we experience any of these problems, it could affect well bores, gathering systems and processing facilities, which could adversely affect our ability to conduct operations. We could also incur substantial losses as a result of:

- injury or loss of life;
- severe damage to and destruction of property, natural resources and equipment;
- pollution and other environmental damage;
- clean-up responsibilities;
- regulatory investigation and penalties;
- suspension of our operations; and
- repairs to resume operations.

Because we intend to use third-party drilling contractors to drill our wells, we may not realize the full benefit of worker compensation laws in dealing with their employees. Our insurance does not protect us against all operational risks. We do not carry business interruption insurance at levels that would provide enough funds for us to continue operating without access to other funds. For some risks, we may not obtain insurance if we believe the cost of available insurance is excessive relative to the risks presented. In addition, pollution and environmental risks generally are not fully insurable. If a significant accident or other event occurs and is not fully covered by insurance, it could impact our operations enough to force us to cease our operations.

The high cost of drilling rigs, equipment, supplies, personnel and other services could adversely affect our ability to execute on a timely basis our development, exploitation and exploration plans within our budget.

Shortages or an increase in cost of drilling rigs, equipment, supplies or personnel could delay or interrupt our operations, which could impact our financial condition and results of operations. Drilling activity in the geographic areas in which we conduct drilling activities may increase, which would lead to increases in associated costs, including those related to drilling rigs, equipment, supplies and personnel and the services and products of other vendors to the industry. Increased drilling activity in these areas may also decrease the availability of rigs. We do not have any contracts with providers of drilling rigs and we cannot assure you that drilling rigs will be readily available when we need them. Drilling and other costs may increase further and necessary equipment and services may not be available to us at economical prices.

Our lease ownership may be diluted due to financing strategies we may employ in the future due to our lack of capital or due to our focus on producing leases.

To accelerate our development efforts we plan to take on working interest partners that will contribute to the costs of drilling and completion and then share in revenues derived from production. In addition, we may in the future, due to a lack of capital or other strategic reasons, establish joint venture partnerships or farm out all or part of our development efforts. These economic strategies may have a dilutive effect on our lease ownership and will more than likely reduce our operating revenues.

In addition, our lease ownership is subject to forfeiture in the event we are unwilling or unable to continue making lease payments. Our leases vary in price per acre and on the term period of the lease. Each lease requires payment to maintain an active lease. In the event we are unable or unwilling to make our lease payments or renew expiring leases, then we will forfeit our rights to such leases. Such forfeiture would prevent us from pursuing development activity on the leased property and could have a substantial impact on our gross leased acreage.

We are subject to complex laws and regulations, including environmental regulations, which can adversely affect the cost, manner or feasibility of doing business.

Development, production and sale of natural gas and oil in the United States are subject to extensive laws and regulations, including environmental laws and regulations. We may be required to make large expenditures to comply with environmental and other governmental regulations. Matters subject to regulation include:

- location and density of wells;
- the handling of drilling fluids and obtaining discharge permits for drilling operations;
- accounting for and payment of royalties on production from state, federal and Indian lands;
- bonds for ownership, development and production of natural gas and oil properties;
- transportation of natural gas and oil by pipelines;
- operation of wells and reports concerning operations; and
- taxation.

Under these laws and regulations, we could be liable for personal injuries, property damage, oil spills, discharge of hazardous materials, remediation and clean-up costs and other environmental damages. Failure to comply with these laws and regulations also may result in the suspension or termination of our operations and subject us to administrative, civil and criminal penalties. Moreover, these laws and regulations could change in ways that substantially increase our costs. Accordingly, any of these liabilities, penalties, suspensions, terminations or regulatory changes could materially adversely affect our financial condition and results of operations enough to possibly force us to cease our business operations.

Our oil and gas operations may expose us to environmental liabilities.

Any leakage of crude oil and/or gas from the subsurface portions of our wells, our gathering system or our storage facilities could cause degradation of fresh groundwater resources, as well as surface damage, potentially resulting in suspension of operation of the wells, fines and penalties from governmental agencies, expenditures for remediation of the affected resource, and liabilities to third parties for property damages and personal injuries. In addition, any sale of residual crude oil collected as part of the drilling and recovery process could impose liability on us if the entity to which the oil was transferred fails to manage the material in accordance with applicable environmental health and safety laws.

Risks Relating To Our Common Stock

Because our common stock is deemed a low-priced “Penny” stock, an investment in our common stock should be considered high risk and subject to marketability restrictions.

Since our common stock is currently under \$5 per share, it is considered a penny stock, as defined in Rule 3a51-1 under the Securities Exchange Act, it will be more difficult for investors to liquidate their investment even if and when a market develops for the common stock. Until the trading price of the common stock rises above \$5.00 per share, if ever, trading in the common stock is subject to the penny stock rules of the Securities Exchange Act specified in rules 15g-1 through 15g-10. Those rules require broker-dealers, before effecting transactions in any penny stock, to:

- Deliver to the customer, and obtain a written receipt for, a disclosure document;
 - Disclose certain price information about the stock;
- Disclose the amount of compensation received by the broker-dealer or any associated person of the broker-dealer;
 - Send monthly statements to customers with market and price information about the penny stock; and
- In some circumstances, approve the purchaser’s account under certain standards and deliver written statements to the customer with information specified in the rules.

Consequently, the penny stock rules may restrict the ability or willingness of broker-dealers to sell the common stock and may affect the ability of holders to sell their common stock in the secondary market and the price at which such holders can sell any such securities. These additional procedures could also limit our ability to raise additional capital in the future.

FINRA sales practice requirements may also limit a stockholder's ability to buy and sell our stock.

In addition to the “penny stock” rules described above, the Financial Industry Regulatory Authority (FINRA) has adopted rules that require that in recommending an investment to a customer, a broker-dealer must have reasonable grounds for believing that the investment is suitable for that customer. Prior to recommending speculative low priced securities to their non-institutional customers, broker-dealers must make reasonable efforts to obtain information about the customer's financial status, tax status, investment objectives and other information. Under interpretations of these rules, FINRA believes that there is a high probability that speculative low priced securities will not be suitable for at least some customers. The FINRA requirements make it more difficult for broker-dealers to recommend that their customers buy our common stock, which may limit your ability to buy and sell our stock and have an adverse effect on the market for our shares.

If we fail to remain current on our reporting requirements, we could be removed from the OTC Markets QB (OTCQB), which would limit the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market.

Companies trading on the OTC Markets QB (OTCQB), such as us, generally must be reporting issuers under Section 12 of the Securities Exchange Act of 1934, as amended, and must be current in their reports under Section 13, in order to maintain price quotation privileges on the OTCQB. More specifically, FINRA has enacted Rule 6530, which determines eligibility of issuers quoted on the OTCQB by requiring an issuer to be current in its filings with the Commission. Pursuant to Rule 6530(e), if we file our reports late with the Commission three times in a two-year period or our securities are removed from the OTCQB for failure to timely file twice in a two-year period, then we will be ineligible for quotation on the OTCQB. As a result, the market liquidity for our securities could be severely adversely affected by limiting the ability of broker-dealers to sell our securities and the ability of stockholders to sell their securities in the secondary market. As of the date of this filing, we have one late filing reported by FINRA.

Our internal controls may be inadequate, which could cause our financial reporting to be unreliable and lead to misinformation being disseminated to the public.

Our management is responsible for establishing and maintaining adequate internal control over financial reporting. As defined in Exchange Act Rule 13a-15(f), internal control over financial reporting is a process designed by, or under the supervision of, the principal executive and principal financial officer and effected by the board of directors, management and other personnel, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles and includes those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of Citadel; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of Citadel are being made only in accordance with authorizations of management and directors of Citadel, and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of Citadel’s assets that could have a material effect on the financial statements.

We have two individuals performing the functions of all officers and directors. These individuals developed our internal control procedures and are responsible for monitoring and ensuring compliance with those procedures. As a result, our internal controls may be inadequate or ineffective, which could cause our financial reporting to be unreliable and lead to misinformation being disseminated to the public. Investors relying upon this misinformation may make an uninformed investment decision.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 3. LEGAL PROCEEDINGS

From time to time, we may become involved in various lawsuits and legal proceedings which arise in the ordinary course of business. However, litigation is subject to inherent uncertainties, and an adverse result in these or other matters may arise from time to time that may harm our business. We are not presently a party to any material litigation, nor to the knowledge of management is any litigation threatened against us, which may materially affect us.

PART II

ITEM MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS
5. ISSUER PURCHASE OF EQUITY SECURITIES

Market Information

Our common stock is quoted on the OTC Markets QB (OTCQB), under the symbol "COIL." Historically, there has not been an active trading market for our common stock. We have been eligible to participate on the OTCQB since November 2010.

The following table sets forth the quarterly high and low bid prices for our common stock during our last two fiscal years, as reported by a Quarterly Trade and Quote Summary Report of the OTC Bulletin Board. The quotations reflect inter-dealer prices, without retail mark-up, markdown or commission, and may not necessarily represent actual transactions.

	2012		2011	
	BID PRICES		BID PRICES	
	High	Low	High	Low
1st Quarter	\$.45	\$.90	\$0	\$0
2nd Quarter	\$.34	\$.73	\$0	\$0
3rd Quarter	\$.10	\$.32	\$.58	\$2.15
4th Quarter	\$.13	\$.50	\$.17	\$1.20

Holders of Common Stock

As of April 1, 2013, we had approximately 75 stockholders of record of the 28,031,640 shares outstanding.

Dividends

The payment of dividends is subject to the discretion of our Board of Directors and will depend, among other things, upon our earnings, our capital requirements, our financial condition, and other relevant factors. We have not paid or declared any dividends upon our common stock since our inception and, by reason of our present financial status and our contemplated financial requirements, do not anticipate paying any dividends upon our common stock in the foreseeable future.

We have never declared or paid any cash dividends. We currently do not intend to pay cash dividends in the foreseeable future on the shares of common stock. We intend to reinvest any earnings in the development and expansion of our business. Any cash dividends in the future to common stockholders will be payable when, as and if declared by our Board of Directors, based upon the Board's assessment of:

- our financial condition;
 - earnings;
 - need for funds;
 - capital requirements;
- prior claims of preferred stock to the extent issued and outstanding; and
 - other factors, including any applicable laws.

Therefore, there can be no assurance that any dividends on the common stock will ever be paid.

Securities Authorized for Issuance under Equity Compensation Plans

We currently do not maintain any equity compensation plans.

Recent Sales of Unregistered Securities

On November 5, 2012, the company received a loan of \$250,000 from a third party. The loan bears interest at 12% per annum with interest due upon maturity. It is due on the earlier of 90 days or upon the consummation by the company of any financing with aggregate proceeds equal to or in excess of \$1,000,000. The lender also received 500,000 warrants with an exercise price of \$0.55.

On November 14, 2012, we issued 250,500 shares of our restricted common stock to a consultant.

On February 4, 2013, we issued 4,086,000 shares of our restricted common stock for cash consideration of \$1,389,240 or \$0.34 per share.

On February 28, we issued 100,000 shares of our restricted common stock for cash consideration of \$34,000 or \$0.34 per share.

On February 28, 2013 we issued 750,000 shares of our restricted common stock for the conversion of a loan and interest in the amount of \$255,000 or \$0.34 per share.

On February 28, 2013 we issued 162,640 shares of our restricted common stock for the conversion of a note payable in the amount of \$55,298 or \$0.34 per share.

On February 28, 2013 we issued 240,000 shares of our restricted common stock for accounting services.

On February 28, 2013 we issued 50,000 shares of our restricted common stock for legal services.

On February 28, 2013 we issued 30,000 shares of our restricted common stock for marketing services.

We believe that the issuance and sale of the above shares was exempt from the registration and prospectus delivery requirements of the Securities Act of 1933 by virtue of Section 4(2) and Regulation D Rule 506. The shares were sold directly by us and did not involve a public offering or general solicitation. The recipients of the shares were afforded an opportunity for effective access to files and records of the Company that contained the relevant information needed to make their investment decision, including the financial statements and 34 Act reports. We reasonably believed that the recipients, immediately prior to the sale of the shares, were accredited investors and had such knowledge and experience in our financial and business matters that they were capable of evaluating the merits and risks of their investment. The recipients had the opportunity to speak with our management on several occasions prior to their investment decision. There were no commissions paid on the issuance and sale of the shares.

Issuer Purchases of Equity Securities

The Company did not repurchase any of its equity securities during the fourth quarter ended December 31, 2012.

ITEM 6. SELECTED FINANCIAL DATA

This item is not applicable, as we are considered a smaller reporting company.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

OVERVIEW AND OUTLOOK

Background

Citadel Exploration, Inc. is a development stage company incorporated in the State of Nevada in December of 2009. On February 28, 2011, we entered into an agreement for the acquisition of 100% of the membership interest of Citadel Exploration, LLC ("CEL"), a California limited liability company.

On March 2, 2011, we changed our name from Subprime Advantage, Inc. to Citadel Explorations, Inc. in anticipation of the completion of the acquisition of 100% of all of the outstanding membership interest of CEL. The acquisition of 100% of the outstanding membership interest of CEL was completed on May 3, 2011. As a result of the completion of the acquisition, we are an oil and gas exploration company with operations in the Salinas Basin of California. As a result of completing the acquisition of 100% of the outstanding membership interest of CEL on May 3, 2011, our focus has been redirected to the oil and gas operations of CEL. We are now an oil and gas exploration, development and production company.

Our Operations

Our principal strategy is to focus on the acquisition of oil and natural gas mineral leases that have known hydrocarbons or are in close proximity to known hydrocarbons that have been underdeveloped. Once acquired, we strive to implement an accelerated development program utilizing capital resources, a regional operating focus, an experienced management and technical team, and enhanced recovery technologies to attempt to increase production and increase returns for our stockholders. Our oil and natural gas acquisition and development activities are currently focused in the State of California.

Currently at Project Indian, we continue to work on obtaining permits, with exploration activities expected to commence in the second half of 2013.

Currently at Project Rancho Grande, the joint venture group continue to permit prospects and are in the early stages of selecting drilling locations, with drilling expected to commence in the second quarter of 2013.

Going Concern

The financial statements included in this filing have been prepared in conformity with generally accepted accounting principles that contemplate the continuance of the Company as a going concern, which contemplates the realization of assets and liquidation of liabilities in the normal course of business. However, the Company is in the development stage and, accordingly, has not generated revenues from operations. As shown on the accompanying financial statements, the Company has incurred a net loss of \$827,847 for the period from inception (November 6, 2006) to December 31, 2012. These conditions raise substantial doubt about the Company's ability to continue as a going concern.

The future of the Company is dependent upon its ability to obtain financing and upon future profitable operations from the development of its oil and gas business opportunities.

RESULTS OF OPERATIONS

For accounting purposes, the acquisition of Citadel Exploration, LLC by the Company has been recorded as a reverse acquisition of a public company and recapitalization of Citadel Exploration, LLC based on the factors demonstrating that Citadel Exploration, LLC represents the accounting acquirer. The historic financial statements of Citadel Exploration, LLC and related entities, while historically presented as an LLC equity structure, have been retroactively presented as a corporation for comparability purposes.

During the years ended December 31, 2012 and 2011, we did not generate revenue.

Operating expenses totaled \$449,642 during the year ended December 31, 2012 as compared to \$216,492 in the prior year ended December 31, 2011. Operating expenses primarily consisted of general and administrative fees, professional fees, executive compensation and amortization and depreciation in the year ended December 31, 2011.

General and administrative fees increased from \$69,137 from the year ended December 31, 2011 to the year ended December 31, 2012 and general and administrative fees – related party increased \$70,430 from the year ended December 31, 2011 to the year ended December 31, 2012. This increase was primarily as a result an increase in general and administrative costs due to the increase in business activities.

Professional fees increased \$74,141 from the year ended December 31, 2011 to the year ended December 31, 2012 and professional fees – related party increased \$60,000 from the year ended December 31, 2011 to the year ended December 31, 2012. This increase was primarily as a result an increase in professional fees due to the increase in reporting requirements related to a public company.

Executive compensation increased \$229,994 from the year ended December 31, 2011 to the year ended December 31, 2012. This increase was primarily as a result of the employment agreements with the CEO and CFO during 2012.

Liquidity and Capital Resources

As of December 31, 2012, we had \$112,580 in cash and \$9,283 in prepaid expenses. The following table provides detailed information about our net cash flow for all financial statement periods presented in this Annual Report. To date, we have financed our operations through the issuance of stock and borrowings.

The following table sets forth a summary of our cash flows for the year ended December 31, 2012 and 2011:

	Years Ended	
	December 31,	
	2012	2011
Net cash used in operating activities	\$(406,395)	\$(138,827)
Net cash provided by investing activities	289,811	(125,412)
Net cash provided by financing activities	227,919	265,484
Net increase in Cash	111,335	1,245
Cash, beginning of year	1,245	-
Cash, end of year	\$112,580	\$1,245

Operating activities

Net cash used in operating activities was \$406,395 for the year ended December 31, 2012. The net cash used in operating activities consisted primarily of professional fees.

Investing activities

Net cash used in investing activities was \$289,811 for the year ended December 31, 2012. The net cash provided by investing activities consisted of proceeds from the sale of a partial interest in an oil& gas property.

Financing activities

Net cash provided by financing activities for the year ended December 31, 2012 was \$227,919. The net cash provided by financing activities was mainly attributable to proceeds from sale of common stock and proceeds from notes payable.

As of December 31, 2012, we continue to use traditional and/or debt financing as well as through the issuance of stock to provide the capital we need to run our business.

Without cash flow from operations we will require additional cash resources, including the sale of equity or debt securities, to meet our planned capital expenditures and working capital requirements for the next 12 months. We will require additional cash resources due to changed business conditions, implementation of our strategy to successfully develop our Shallow Indian Oil Development Project, or acquisitions we may decide to pursue. If our own financial resources and then current cash-flows from operations are insufficient to satisfy our capital requirements, we may seek to sell additional equity or debt securities or obtain additional credit facilities. The sale of additional equity securities will result in dilution to our stockholders. The incurrence of indebtedness will result in increased debt service obligations and could require us to agree to operating and financial covenants that could restrict our operations or

modify our plans to grow the business. Financing may not be available in amounts or on terms acceptable to us, if at all. Any failure by us to raise additional funds on terms favorable to us, or at all, will limit our ability to expand our business operations and could harm our overall business prospects.

Our ability to obtain additional capital through additional equity and/or debt financing, and Joint Venture or Working Interest partnerships will also be important to our expansion plans. In the event we experience any significant problems assimilating acquired assets into our operations or cannot obtain the necessary capital to pursue our strategic plan, we may have to reduce the growth of our operations. This may materially impact our ability to increase revenue and continue our growth.

Off-Balance Sheet Arrangements

As of the date of this Report, we did not have any off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

Operation Plan

Our plan is to focus on the acquisition and drilling of prospective oil and natural gas mineral leases. Once we have tested a prospect as productive, subject to availability of capital, we will implement a development program with a regional operating focus in order to increase production and increase returns for our stockholders. Exploration, acquisition and development activities are currently focused in California. Depending on availability of capital, and other constraints, our goal is to increase stockholder value by finding and developing oil and natural gas reserves at costs that provide an attractive rate of return on our investments.

We expect to achieve these results by:

- Investing capital in exploration and development drilling and in secondary and tertiary recovery of oil as well as natural gas;
- Using the latest technologies available to the oil and natural gas industry in our operations;
- Finding additional oil and natural gas reserves on the properties we acquire.

In addition to raising additional capital we plan to take on Joint Venture (JV) or Working Interest (WI) partners who may contribute to the capital costs of drilling and completion and then share in revenues derived from production. This economic strategy may allow us to utilize our own financial assets toward the growth of our leased acreage holdings, pursue the acquisition of strategic oil and gas producing properties or companies and generally expand our existing operations.

Because of our limited operating history we have yet to generate any revenues from the sale of oil or natural gas. Our activities have been limited to raising capital, negotiating WI agreements, becoming a publicly traded company and preliminary analysis of reserves and production capabilities from our exploratory test wells.

Our future financial results will depend primarily on: (i) the ability to continue to source and screen potential projects; (ii) the ability to discover commercial quantities of natural gas and oil; (iii) the market price for oil and natural gas; and (iv) the ability to fully implement our exploration and development program, which is dependent on the availability of capital resources. There can be no assurance that we will be successful in any of these respects, that the prices of oil and gas prevailing at the time of production will be at a level allowing for profitable production, or that we will be able to obtain additional funding to increase our currently limited capital resources.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

This item is not applicable as we are currently considered a smaller reporting company.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

See Index to Financial Statements and Financial Statement Schedules appearing on page F-1 through F-16 of this Form 10-K.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

We have had no disagreements with our independent auditors on accounting or financial disclosures.

ITEM 9A (T). CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our Principal Executive Officer, Armen Nahabedian and Principal Financial Officer, Philip McPherson, have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended) as of the end of the period covered by this Report. Based on their evaluation, they concluded that our disclosure controls and procedures are designed at a reasonable assurance level and are effective to provide reasonable assurance that information we are required to disclose in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Management's Report on Internal Control Over Financial Reporting

Our management is responsible for establishing and maintaining adequate internal control, as is defined in the Securities Exchange Act of 1934. These internal controls are designed to provide reasonable assurance that the reported financial information is presented fairly, that disclosures are adequate and that the judgments inherent in the preparation of financial statements are reasonable. There are inherent limitations in the effectiveness of any system of internal controls, including the possibility of human error and overriding of controls. Consequently, an effective internal control system can only provide reasonable, not absolute, assurance with respect to reporting financial information.

Our internal control over financial reporting includes policies and procedures that: (i) pertain to maintaining records that in reasonable detail accurately and fairly reflect our transactions; (ii) provide reasonable assurance that transactions are recorded as necessary for preparation of our financial statements in accordance with generally accepted accounting principles and the receipts and expenditures of company assets are made and in accordance with our management and directors authorization; and (iii) provide reasonable assurance regarding the prevention or timely detection of unauthorized acquisition, use or disposition of assets that could have a material effect on our financial statements.

Management has undertaken an assessment of the effectiveness of our internal control over financial reporting based on the framework and criteria established in the Internal Control – Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based upon this evaluation, management concluded that our internal control over financial reporting was not effective as of December 31, 2012.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management’s report was not subject to attestation by our registered public accounting firm pursuant to the temporary rules of the Securities and Exchange Commission that permit the company to provide only management’s report in this annual report.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. OTHER INFORMATION

None.

PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

Directors and Executive Officers

The names of our directors and executive officers and their ages, positions, and biographies are set forth below. Our executive officers are appointed by, and serve at the discretion of, our board of directors. There are no family relationships among any of our directors or executive officers.

Name	Age	Title	Term
Armen Nahabedian	34	Chief Executive Officer, President & Director	8/9/2011
Daniel Szymanski	50	Chairman of the Board	5/3/2011
Philip J. McPherson	38	Chief Financial Officer, Secretary, Treasurer & Director	9/1/2012
Jacob L. Barnhart	33	Director	5/3/2011
James Borgna	34	Director	5/3/2011

Armen Nahabedian, 34, President, Chief Executive Officer, and a Director: Mr. Nahabedian is a fourth generation oil and gas explorer in the state of California. In 1999, Mr. Nahabedian joined the United States Marine Corp as an infantryman and reached the rank of Corporal (E-4) before serving in operation Iraqi Freedom and receiving an honorable discharge in 2003. Mr. Nahabedian immediately thereafter went to work in the oil fields of the South San Joaquin Valley for his family's oil company, The Nahabedian Exploration Group. After early success in his exploration efforts Mr. Nahabedian became a regional supervisor and managed the drilling operations for some of the deepest exploratory wells drilled in the state of California from 2004 through 2007. In 2007, Mr. Nahabedian then joined The Nahabedian Exploration Group as a partner and supervised land acquisition efforts (over 750,000 acres leased or optioned) and prospect generation. Mr. Nahabedian continued to act as an operational supervisor and in 2009, he became involved in business development and finance. Acting as the company's primary fund raiser Mr. Nahabedian educated his self in public financing and securities and with the assistance of an experienced legal team formed Citadel Exploration, Inc. in 2011.

Daniel L. Szymanski, 50, Chairman of the Board: Dan Szymanski comes to the board of Citadel Exploration, Inc. with over 20 years of industry experience, including exploration and production assignments with Tenneco and Chevron, and worldwide exploration with Occidental. Dan served as Manager of Business Development, then Manager-Financial Planning and Analysis at Oxy's Headquarters in LA. His final role at Oxy was Asset Manager for 42 oil and gas fields producing in California's San Joaquin and Sacramento Valleys. Since 2008, Dan has been a consultant to the oil and gas industry and partner in a seismic data firm. Mr. Szymanski has a Bachelors in Geology from the University of Wisconsin and a Masters in Geophysics from Purdue.

Philip J. McPherson, 38 Chief Financial Officer and Director: Mr. McPherson joined Citadel Exploration in September of 2012 with nearly two decades of experience in the capital markets and financial services sectors. He started his career as a retail stock broker with Mission Capital in 1997 and became partner before it was acquired by oil and gas boutique C. K. Cooper & Company. At C.K. Cooper, Mr. McPherson was a research analyst specializing in small cap exploration & production companies. In 2007, he joined Global Hunter Securities as a partner and managing director of the energy research group. During his Wall Street career, Mr. McPherson was presented the Wall Street Journal "Best on the Street" Award was named a Zack's 5-Start Analyst for three consecutive years. He is a recognized expert on California E&P firms. Mr. McPherson received his Bachelors in Economics from East Carolina University.

Jacob Barnhart, 33, Director: Mr. Barnhart has been working in the financial sector for the last four years as a financial advisor for Ameriprise. Prior to receiving his bachelor's degree in sociology from Seattle University, Jacob served four years in the United States Marine Corps and reached the rank of corporal. Mr. Barnhart has a tremendous work ethic and prides himself on the leadership traits he obtained while serving his country.

James Borgna, 34, Director: Mr. Borgna is a third generation oil and gas industry supplier and producer. Mr. Borgna currently owns and operates KVOS LLC which supplies production facilities and process equipment in California. Mr. Borgna specializes in scalable facilities that are fabricated work in-house. Mr. Borgna has supervised the fabrication of oil and gas facilities for many of the major operators in the San Joaquin Basin. Mr. Borgna gained valuable experience with project management, facilities design, and gained familiarity with permitting guidelines and restrictions. Prior to joining his family in the oil and gas industry Mr. Borgna served six years in the United States Navy and achieved the rank of E-5.

Indemnification of Directors and Officers

Our Articles of Incorporation and Bylaws both provide for the indemnification of our officers and directors to the fullest extent permitted by Nevada law.

Limitation of Liability of Directors

Pursuant to the Nevada General Corporation Law, our Articles of Incorporation exclude personal liability for our Directors for monetary damages based upon any violation of their fiduciary duties as Directors, except as to liability for any breach of the duty of loyalty, acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law, or any transaction from which a Director receives an improper personal benefit. This exclusion of liability does not limit any right which a Director may have to be indemnified and does not affect any Director's liability under federal or applicable state securities laws. We have agreed to indemnify our directors against expenses, judgments, and amounts paid in settlement in connection with any claim against a Director if he acted in good faith and in a manner he believed to be in our best interests.

Election of Directors and Officers

Directors are elected to serve until the next annual meeting of stockholders and until their successors have been elected and qualified. Officers are appointed to serve until the meeting of the Board of Directors following the next annual meeting of stockholders and until their successors have been elected and qualified.

Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), requires our executive officers and directors, and persons who beneficially own more than ten percent of our common stock, to file initial reports of ownership and reports of changes in ownership with the SEC. Executive officers, directors and greater-than-ten-percent beneficial owners are required by SEC regulations to furnish us with copies of all Section 16(a) forms they file. Based upon a review of the copies of such forms furnished to us and written representations from our executive officers and directors, we believe that as of the date of this filing they were current in their filings except for Christopher Whitcomb, CFO and a Director of the Company, and Jacob Borgna, a Director of the Company, who have not filed their initial Form 3 filing.

Code of Ethics

A code of ethics relates to written standards that are reasonably designed to deter wrongdoing and to promote:

- (1) Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships;
- (2) Full, fair, accurate, timely and understandable disclosure in reports and documents that are filed with, or submitted to, the Commission and in other public communications made by an issuer;
- (3) Compliance with applicable governmental laws, rules and regulations;
- (4) The prompt internal reporting of violations of the code to an appropriate person or persons identified in the code; and
- (5) Accountability for adherence to the code.

We have not adopted a corporate code of ethics that applies to our principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions.

Our decision to not adopt such a code of ethics results from our having a small management for the Company. We believe that the limited interaction which occurs having such a small management structure for the Company eliminates the current need for such a code, in that violations of such a code would be reported to the party generating the violation.

Corporate Governance

We currently do not have standing audit, nominating and compensation committees of the board of directors, or committees performing similar functions. Until formal committees are established, our entire board of directors, perform the same functions as an audit, nominating and compensation committee.

Involvement in Certain Legal Proceedings

To the best of our knowledge, none of our directors or executive officers has, during the past five years:

- been convicted in a criminal proceeding or been subject to a pending criminal proceeding (excluding traffic violations and other minor offences);
- had any bankruptcy petition filed by or against the business or property of the person, or of any partnership, corporation or business association of which he was a general partner or executive officer, either at the time of the bankruptcy filing or within two years prior to that time;
- been subject to any order, judgment, or decree, not subsequently reversed, suspended or vacated, of any court of competent jurisdiction or federal or state authority, permanently or temporarily enjoining, barring, suspending or otherwise limiting, his involvement in any type of business, securities, futures, commodities, investment, banking, savings and loan, or insurance activities, or to be associated with persons engaged in any such activity;
- been found by a court of competent jurisdiction in a civil action or by the SEC or the Commodity Futures Trading Commission to have violated a federal or state securities or commodities law, and the judgment has not been reversed, suspended, or vacated;
- been the subject of, or a party to, any federal or state judicial or administrative order, judgment, decree, or finding, not subsequently reversed, suspended or vacated (not including any settlement of a civil proceeding among private litigants), relating to an alleged violation of any federal or state securities or commodities law or regulation, any law or regulation respecting financial institutions or insurance companies including, but not limited to, a temporary or permanent injunction, order of disgorgement or restitution, civil money penalty or temporary or permanent cease-and-desist order, or removal or prohibition order, or any law or regulation prohibiting mail or wire fraud or fraud in connection with any business entity; or
- been the subject of, or a party to, any sanction or order, not subsequently reversed, suspended or vacated, of any self-regulatory organization (as defined in Section 3(a)(26) of the Exchange Act (15 U.S.C. 78c(a)(26))), any registered entity (as defined in Section 1(a)(29) of the Commodity Exchange Act (7 U.S.C. 1(a)(29))), or any equivalent exchange, association, entity or organization that has disciplinary authority over its members or persons associated with a member.

ITEM 11. EXECUTIVE COMPENSATION

Overview of Compensation Program

We currently have not appointed members to serve on the Compensation Committee of the Board of Directors. Until a formal committee is established, our entire Board of Directors has responsibility for establishing, implementing and continually monitoring adherence with the Company's compensation philosophy. The Board of Directors ensures that the total compensation paid to the executives is fair, reasonable and competitive.

Compensation Philosophy and Objectives

The Board of Directors believes that the most effective executive compensation program is one that is designed to reward the achievement of specific annual, long-term and strategic goals by the Company and that aligns executives' interests with those of the stockholders by rewarding performance above established goals, with the ultimate objective of improving stockholder value. As a result of the size of the Company, the Board evaluates both performance and compensation on an informal basis. Upon hiring additional executives, the Board intends to establish a Compensation Committee to evaluate both performance and compensation to ensure that the Company maintains its ability to attract and retain superior employees in key positions and that compensation provided to key employees remains competitive relative to the compensation paid to similarly-situated executives of peer companies. To that end, the Board believes executive compensation packages provided by the Company to its executives, including the named executive officers, should include both cash and stock-based compensation that reward performance as measured against established goals.

Role of Executive Officers in Compensation Decisions

The Board of Directors makes all compensation decisions for, and approves recommendations regarding equity awards to, the executive officers and Directors of the Company. Decisions regarding the non-equity compensation of other employees of the Company are made by management.

Summary Compensation

During the year ended December 31, 2010, our former President and Chief Executive Officer Ms. Molly Country received \$2,000 in compensation for her role as an executive officer of the Company. Ms. Country resigned from her position with the Company effective on May 3, 2011.

During the year ended December 31, 2011, Mr. Nahabedian received \$936 in compensation for his role as the Company's Chief Executive Officer. Mr. Whitcomb did not receive compensation for his role as Chief Financial Officer. Additionally, as of December 31, 2011, Mr. Finch, former Chief Executive Officer, received \$34,000 in compensation for his role as an executive officer of the Company.

During the year ended December 31, 2012, we entered into employment contracts with both our CEO and CFO on September 1, 2012. The contract calls for each to receive a base salary of \$10,000 per month for the first 12 months. The base salary shall increase to \$15,000 per month for the next 12 month period and then increase to \$20,000 per month for the final 12 months of the three year contract. The CEO & CFO are also entitled to quarterly and annual bonuses upon reaching mutually agreeable objectives set by Employer and Employee. The CEO & CFO shall be entitled to receive and or participate in all benefit plans and programs of Employer currently existing or hereafter made available to executives and or senior management of the Employer.

Summary Compensation Table

The table below summarizes the total compensation paid to or earned by our Executive Officers, for the last two fiscal years ended December 31, 2012 and 2011.

Name and Principal Positions	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	SUMMARY COMPENSATION TABLE			Total (\$)
						Non-Equity Incentive Plan Compensation (\$)	Non-qualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	
Armen Nahabedian, Chief Executive Officer, President, and Director (1)	2012	40,000	-0-	-0-	74,997	-0-	-0-	-0-	114,997
	2011	-0-	-0-	-0-	-0-	-0-	-0-	-0-	-0-
Philip McPherson Chief Financial Officer, Secretary, Treasurer, and Director (2)	2012	40,000	-0-	-0-	74,997	-0-	-0-	-0-	114,997

- (1) Mr. Nahabedian was appointed Chief Executive Officer, President, and a Director of the Company on August 9, 2011.
- (2) Mr. McPherson was appointed Chief Financial Officer, Secretary, Treasurer, and a Director of the Company on September 1, 2012.

Termination of Employment

With the addaptation of employment contracts for the company's CEO and CFO, in the event of a change of control the CEO and CFO are entitled to two years of current monthly salary and two years of medical insurance. Additionally all unvested stock options immediately vest.

Option Grants in Last Fiscal Year

During the years ended December 31, 2012 we granted both the CEO and CFO 2,000,000 stock options at \$0.20 in September of 2012. Of these options 500,000 vested immediately and the balance vest on a three year term of 500,000 each year.

Director Compensation

As a result of having limited resources we do not currently have an established compensation package for our board members.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth information, to the best of our knowledge, about the beneficial ownership of our common stock on April 1, 2013 relating to the beneficial ownership of our common stock by those persons known to beneficially own more than 5% of our capital stock and by our directors and executive officers. The percentage of beneficial ownership for the following table is based on 28,031,640 shares of common stock outstanding.

Beneficial ownership is determined in accordance with the rules of the Securities and Exchange Commission and does not necessarily indicate beneficial ownership for any other purpose. Under these rules, beneficial ownership includes those shares of common stock over which the stockholder has sole or shared voting or investment power. The percentage ownership of the outstanding common stock, however, is based on the assumption, expressly required by the rules of the Securities and Exchange Commission, that only the person or entity whose ownership is being reported has converted options or warrants into shares of our common stock.

Security Ownership of Certain Beneficial Owners and Management

Title of Class	Name and address of Beneficial Owner(1)	Number Of Shares	Percent Beneficially Owned
Common	Armen Nahabedian, Chief Executive Officer, President & Director	4,635,000(2)	17.0%
Common	Daniel L. Szymanski, Chairman of the Board	250,000	1.0%
Common	Philip J. McPherson, CFO & Director	2,000,000	7.0%
Common	Jacob L. Barnhart, Director	200,000	0.9%
Common	James Borgna, Director	200,000	0.9%
Common	Vahagn Nahabedian	4,000,000	14.0%
	All Beneficial Owners as a Group	11,285,000	40.0%

(1) As used in this table, “beneficial ownership” means the sole or shared power to vote, or to direct the voting of, a security, or the sole or shared investment power with respect to a security (i.e., the power to dispose of, or to direct the disposition of, a security). Each Parties’ address is care of the Company at 417 31st St. Unit A, Newport Beach, CA 92663

(2) The 4,635,000 shares are indirectly owned by Armen Nahabedian and directly owned by Gold or Glory Corporation, of which Mr. Armen Nahabedian is a shareholder.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPNDENCE

Transactions with Related Persons

As of December 31, 2012, the Company had notes payable totaling \$32,240 due to one entity that is controlled by an officer, director and stockholder of the Company.

As of December 31, 2012, the Company had notes payable totaling \$2,750 due to one entity that is controlled by an director of the Company.

Promoters and Certain Control Persons

We did not have any promoters at any time since our inception in December 2009.

Director Independence

We currently have three independent directors, as the term “independent” is defined in Section 803A of the NYSE Amex LLC Company Guide. Since the OTCQB does not have rules regarding director independence, the Board makes its determination as to director independence based on the definition of “independence” as defined under the rules of the New York Stock Exchange (“NYSE”) and American Stock Exchange (“Amex”).

ITEM 14. PRINCIPAL ACCOUNTING FEES AND SERVICES

(1) AUDIT FEES

Audit and Non-Audit Fees

The following table sets forth the fees paid or accrued by us for the audit and other services provided by De Joya Griffith & Company, LLC for the audit of our annual financial statements for the years ended December 31, 2012 and December 31, 2011:

		Fiscal Year Ended December 31, 2012	Fiscal Year Ended December 31, 2011
Audit Fees(1)	\$	\$21,800	\$10,600
Audit-Related Fees		\$-	-
Tax Fees		\$-	-
All Other Fees		\$-	-
Total	\$	\$21,800	\$10,600

(1) Audit Fees: This category represents fees for professional services provided in connection with the audit of our financial statements and review of our quarterly financial statements.

(2) AUDIT-RELATED FEES

None.

(3) TAX FEES

None.

(4) ALL OTHER FEES

None.

(5) AUDIT COMMITTEE POLICIES AND PROCEDURES

We do not have an audit committee.

(6) If greater than 50 percent, disclose the percentage of hours expended on the principal accountant's engagement to audit the registrant's financial statements for the most recent fiscal year that were attributed to work performed by persons other than the principal accountant's full-time, permanent employees.

Not applicable.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENT SCHEDULES

(a) We have filed the following documents as part of this Annual Report on Form 10-K:

1. The financial statements listed in the "Index to Financial Statements" at page are filed as part of this report.
2. Financial statement schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.
3. Exhibits included or incorporated herein: See index to Exhibits.

Exhibit Index

Exhibit Number	Exhibit Description	Filed herewith	Incorporated by reference			
			Form	Period ending	Exhibit	Filing date
3(i)(a)	Articles of Incorporation of Citadel Exploration, Inc.		S-1		3(i)(a)	2/11/10
3(i)(b)	Certificate of Amendment – Name Change – Dated March 3, 2011		8-K		3(i)(b)	3/10/11
3(i)(c)	Certificate of Change – Dated March 3, 2011		8-K		3(i)(c)	3/10/11
3(ii)(a)	Bylaws of Citadel Exploration, Inc.		S-1		3(ii)(a)	2/11/10
10.1	Membership Purchase Agreement and Plan of Reorganization– Dated February 28, 2011		8-K		2.1	3/31/11
10.2	Addendum No. 1 to Membership Purchase Agreement and Plan of Reorganization – Dated April 27, 2011		8-K		2.2	5/3/11
10.3	Letter Agreement – Dated February 22, 2012		8-K		10.1	3/22/12
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002	X				
32.1	Certifications of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the	X				

32.2	Sarbanes-Oxley Act of 2002 Certifications of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X	
99.2	Presentation – Dated November 10, 2011	8-K	EEX. 99.2 111/15/12
101.INS**	XBRL Instance Document	X	
101.SCG**	XBRL Taxonomy Extension Schema	X	
101.CAL**	XBRL Taxonomy Extension Calculation Linkbase	X	
101.DEF	XBRL Taxonomy Extension Definition Linkbase	X	
101.LAB**	XBRL Taxonomy Extension Label Linkbase	X	
101.PRE**	XBRL Taxonomy Extension Presentation Linkbase	X	

** XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused the report to be signed on its behalf by the undersigned, thereunto duly authorized.

CITADEL EXPLORATION, INC.

By:
Armen Nahabedian, President

Date: April 1, 2013

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

Signature	Title	Date
/S/ Armen Nahabedian Armen Nahabedian	Chief Executive Officer (Principal Executive Officer), President, and Director	April 1, 2013
/S/ Philip J. McPherson Philip J. McPherson	Chief Financial Officer (Principal Financial Officer) Secretary, Treasurer, and Director	April 1, 2013
/S/ Daniel L. Szymanski Daniel L. Szymanski	Chairman of the Board	April 1, 2013
/S/ Jacob Barnhart Jacob L. Barnhart	Director	April 1, 2013
/S/ James Borgna James Borgna	Director	April 1, 2013

CITADEL EXPLORATION, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS
AS OF DECEMBER 31, 2012 AND 2011

	PAGES
REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM	F-1
CONSOLIDATED BALANCE SHEETS	F-2
CONSOLIDATED STATEMENTS OF OPERATIONS	F-3
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)	F-4
CONSOLIDATED STATEMENTS OF CASH FLOWS	F-5
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS	F-6 – F-16

Office Locations

Las Vegas, NV
New York, NY
Pune, India
Beijing, China

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
Citadel Exploration, Inc.

We have audited the accompanying consolidated balance sheets of Citadel Exploration, Inc. (An Exploration Stage Company) (the "Company") as of December 31, 2012 and 2011 and the related consolidated statements of operations, stockholders' equity, and cash flows for the years ended December 31, 2012 and 2011 and for the period from inception (November 6, 2006) to December 31, 2012 and 2011. Citadel Exploration, Inc. management is responsible for these consolidated financial statements. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over the financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Citadel Exploration, Inc. (An Exploration Stage Company) as of December 31, 2012 and 2011 and the results of their operations and their cash flows for the year ended December 31, 2012 and 2011 and for the periods from inception (November 6, 2006) to December 31, 2012 and 2011, in conformity with accounting principles generally accepted in the United States of America.

The accompanying consolidated financial statements have been prepared assuming the Company will continue as a going concern. As discussed in Note 2 to the consolidated financial statements, the Company has suffered recurring losses from operations, which raise substantial doubt about its ability to continue as a going concern. Management's plans regarding these matters are also described in Note 2. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ De Joya Griffith, LLC
Henderson, Nevada
March 28, 2013

CITADEL EXPLORATION, INC.
(AN EXPLORATION STAGE COMPANY)
CONSOLIDATED BALANCE SHEETS
(audited)

	December 31, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash	\$ 112,580	\$ 1,245
Other receivable	7,253	-
Prepaid expenses	9,283	16,664
Prepaid stock-based compensation	-	60,000
Total current assets	129,116	77,909
Oil and gas properties		
Fixed asset, net	159,833	205,360
Website, net	20,299	-
	649	1,108
Total assets	\$ 309,897	\$ 284,377
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Overdraft in trust account	\$-	\$ 286
Accounts payable	22,438	107,709
Accrued executive compensation	80,000	-
Accrued interest payable	11,217	1,907
Accrued interest payable - related party	3,607	2,504
Notes payable, net	222,527	55,498
Notes payable - related party	34,990	131,450
Total current liabilities	374,779	299,354
Total liabilities	374,779	299,354
Stockholders' deficit:		
Common stock, \$0.001 par value, 100,000,000 shares authorized, 22,613,000 and 20,320,000 shares issued and outstanding as of December 31, 2012 and December 31, 2011, respectively	22,613	20,320
Additional paid-in capital	740,352	160,958
Stock payable	-	34,000
Deficit accumulated during development stage	(827,847)	(230,255)
Total stockholders' deficit	(64,882)	(14,977)

Total liabilities and stockholders' deficit	\$309,897	\$284,377
---	-----------	-----------

See accompanying notes to consolidated financial statements.

F-2

CITADEL EXPLORATION, INC.
 (AN EXPLORATION STAGE COMPANY)
 CONSOLIDATED STATEMENTS OF OPERATIONS
 (audited)

	For the years ended		Inception (November 6, 2006) to December 31, 2012
	December 31, 2012	2011	
Revenue	\$-	\$-	\$-
Operating expenses:			
General and administrative	132,054	62,917	196,512
General and administrative - related party	70,430	-	70,430
Amortization and depreciation	3,732	267	3,999
Professional fees	227,449	153,308	380,757
Professional fees - related party	60,000	-	60,000
Executive compensation	229,994	-	229,994
Gain on sale of interest in oil & gas properties	(267,856)	-	(267,856)
Gain on settlement of accounts payable	(6,161)	-	(6,161)
Total operating expenses	449,642	216,492	667,675
Other expenses:			
Interest expense	(143,556)	(3,889)	(147,445)
Interest expense - related party	(2,794)	(2,504)	(5,298)
Total other expenses	(146,350)	(6,393)	(152,743)
Net loss before provision for income taxes	(595,992)	(222,885)	(820,418)
Provision for income taxes	1,600	1,600	7,429
Net loss	\$(597,592)	\$(224,485)	\$(827,847)
Weighted average number of common shares outstanding - basic	21,063,016	18,165,260	
Net loss per share - basic	\$(0.03)	\$(0.01)	

See accompanying notes to consolidated financial statements.

CITADEL EXPLORATION, INC.
(FORMERLY SUBPRIME ADVANTAGE, INC.)
(AN EXPLORATION STAGE COMPANY)
STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)
(AUDITED)

	Common Shares		Additional Paid-In	Stock	Deficit Accumulated During Exploration	Total Stockholders' Equity (Deficit)
	Shares	Amount	Capital	Payable	Stage	
Balance, November 6, 2006	-	\$-	\$-	\$-	\$ -	\$ -
December 31, 2006						
Member contribution	14,000,000	14,000	(13,600)	-	-	400
Net loss	-	-	-	-	(805)	(805)
Balance, December 31, 2006	14,000,000	14,000	(13,600)	-	(805)	(405)
December 31, 2007						
Member contribution	-	-	40,800	-	-	40,800
Net loss	-	-	-	-	(1,140)	(1,140)
Balance, December 31, 2007	14,000,000	14,000	27,200	-	(1,945)	39,255
December 31, 2008						
Member contribution	-	-	12,000	-	-	12,000
December 31, 2008						
Member distribution	-	-	(10,000)	-	-	(10,000)
Net loss	-	-	-	-	(1,943)	(1,943)
Balance, December 31, 2008	14,000,000	14,000	29,200	-	(3,888)	39,312
December 31, 2009						
Member contribution	-	-	43,093	-	-	43,093
Net loss	-	-	-	-	(1,082)	(1,082)
Balance, December 31, 2009	14,000,000	14,000	72,293	-	(4,970)	81,323
Net loss	-	-	-	-	(800)	(800)

Edgar Filing: Citadel Exploration, Inc. - Form 10-K

Balance, December 31, 2010	14,000,000	14,000	72,293	-	(5,770)	80,523
March 31, 2011						
Member contribution	-	-	27,761	-	-	27,761
May 3, 2011						
Recapitalization	6,200,000	6,200	(35,465)	-	-	(29,265)
May 20, 2011						
Issuance of common stock for cash	20,000	20	15,980	34,000	-	50,000
October 1, 2011						
Issuance of common stock for services	100,000	100	79,900	-	-	80,000
December 31, 2011						
Donated capital	-	-	489	-	-	489
Net loss	-	-	-	-	(224,485)	(224,485)
Balance, December 31, 2011	20,320,000	\$20,320	\$160,958	\$34,000	\$ (230,255)	\$ (14,977)
January 31, 2012						
Donated capital	-	-	980	-	-	980
May 7, 2012						
Issuance of common stock for stock payable	42,500	43	33,957	(34,000)	-	-
July 1, 2012						
Forgiveness of debt with related party	-	-	50,953	-	-	50,953
July 12, 2012						
Issuance of common stock for services	250,500	250	48,180	-	-	48,430
September 1, 2012						
Issuance of stock options for employment agreements	-	-	149,994	-	-	149,994
September 13, 2012						
Issuance of common stock for cash	2,000,000	2,000	78,000	-	-	80,000
November 15, 2012						
Issuance of warrants as part of note payable	-	-	217,330	-	-	217,330
Net loss	-	-	-	-	(597,592)	(597,592)

Balance, December 31, 2012	22,613,000	\$22,613	\$740,352	\$-	\$ (827,847)	\$ (64,882)
----------------------------	------------	----------	-----------	-----	---------------	--------------

See Accompanying Notes to Consolidated Financial Statements.

F-4

CITADEL EXPLORATION, INC.
 (AN EXPLORATION STAGE COMPANY)
 CONSOLIDATED STATEMENTS OF CASH FLOWS
 (audited)

	2012	For the years ended December 31, 2011	Inception (November 6, 2006) to December 31, 2012
CASH FLOWS FROM OPERATING ACTIVITIES			
Net loss	\$ (597,592)	\$ (224,485)	\$ (827,847)
Adjustments to reconcile net loss to net cash used in operating activities:			
Amortization and depreciation	3,732	267	3,999
Amortization of prepaid stock compensation	60,000	20,000	80,000
Amortization of debt discount	132,813	-	132,813
Gain on sale of interest in oil & gas properties	(267,856)	-	(267,856)
Gain on settlement of accounts payable	(6,161)	-	(6,161)
Options issued for executive compensation	149,994	-	149,994
Shares issued for consulting	48,430	-	48,430
Changes in operating assets and liabilities:			
Increase in other receivable	(7,253)	-	(7,253)
Decrease (increase) in prepaid expenses	7,381	(16,664)	(9,283)
Increase (decrease) in accounts payable	(20,296)	77,644	58,148
Increase in accrued executive compensation	80,000	-	80,000
Increase in accrued interest payable	9,310	2,504	11,814
Increase in accrued interest payable - related party	1,103	1,907	3,010
Net cash used in operating activities	(406,395)	(138,827)	(550,192)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase oil and gas properties	(36,617)	(124,037)	(241,977)
Proceeds from sale of interest in oil & gas properties	350,000	-	350,000
Website	-	(1,375)	(1,375)
Purchase fixed assets	(23,572)	-	(23,572)
Net cash provided by (used in) investing activities	289,811	(125,412)	83,076
CASH FLOWS FROM FINANCING ACTIVITIES			
	(286)	286	-

Edgar Filing: Citadel Exploration, Inc. - Form 10-K

Increase/ (decrease) in overdraft from trust account			
Member contributions	980	28,250	105,523
Member distribution	-	-	10,000
Proceeds from sale of common stock	80,000	50,000	130,000
Proceeds from notes payable	264,763	55,498	320,261
Repayments for notes payable	(21,078)	-	(21,078)
Proceeds from notes payable - related party	66,563	131,450	198,013
Repayments for notes payable - related party	(163,023)	-	(163,023)
Net cash provided by financing activities	227,919	265,484	579,696
NET CHANGE IN CASH	111,335	1,245	112,580
CASH AT BEGINNING OF YEAR	1,245	-	-
CASH AT END OF YEAR	\$ 112,580	\$ 1,245	\$ 112,580

SUPPLEMENTAL INFORMATION:

Interest paid	\$ -	\$ -	\$ -
Income taxes paid	\$ -	\$ -	\$ -

NON-CASH INVESTING AND FINANCING ACTIVITIES:

Liabilities assumed with the acquisition of Citadel Exploration, LLC			
Citadel Exploration, LLC	\$ -	\$ -	\$ 29,265
Shares issued for prepaid stock compensation	\$ -	\$ -	\$ 80,000
Financing of insurance	\$ 14,963	\$ -	\$ 14,963
Forgiveness of debt due to related party	\$ 50,953	\$ -	\$ 50,953

See Accompanying Notes to Consolidated Financial Statements.

CITADEL EXPLORATION, INC.
(AN EXPLORATION STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(AUDITED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Citadel Exploration, Inc. ("Citadel Inc") was incorporated on December 17, 2009 in the State of Nevada originally under the name Subprime Advantage, Inc. On March 2, 2011, the Company changed its name from Subprime Advantage, Inc. to Citadel Exploration, Inc.

On May 3, 2011, Citadel Inc completed the acquisition of 100% interest in Citadel Exploration, LLC, a California limited liability company, ("Citadel LLC") pursuant to a Membership Purchase Agreement (the "MPA"). Under the MPA, Citadel Inc issued 14,000,000 shares of its common stock to an individual in exchange for a 100% interest in Citadel LLC. Additionally under the MPA, the former officers and directors of Citadel Inc agreed to cancel 7,696,000 shares of its common stock. For accounting purposes, the acquisition of the Citadel LLC by Citadel Inc has been accounted for as a recapitalization, similar to a reverse acquisition except no goodwill is recorded, whereby the private company, Citadel LLC, in substance acquired a non-operational public company (Citadel Inc) with nominal assets and liabilities for the purpose of becoming a public company. Accordingly, Citadel LLC are considered the acquirer for accounting purposes and thus, the historical financials are primarily that of Citadel LLC. As a result of this transaction, Citadel Inc changed its business direction and is now involved in the acquisition and development of oil and gas resources in California. Citadel LLC was incorporated on November 6, 2006 (Date of Inception) and accordingly, the accompanying financial statements are from the Date of Inception of Citadel LLC through ending reporting periods reflected.

The Company has not commenced any significant operations and, in accordance with ASC Topic 915, the Company is considered an exploration stage company.

The financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to exploration stage enterprises, and are expressed in U.S. dollars. The Company's fiscal year end is December 31.

Principles of consolidation

For the years ended December 31, 2012 and 2011, the consolidated financial statements include the accounts of Citadel Exploration, Inc. and Citadel Exploration, LLC. All significant intercompany balances and transactions have been eliminated. Citadel Exploration, Inc. and Citadel Exploration, LLC will be collectively referred herein to as the "Company".

Nature of operations

Currently, the Company is focused on the acquisition and development of oil and gas resources in California. The Company has not yet found oil and gas resources in commercially exploitable quantities and is engaged in exploring land in an effort to discover them. The Company has been in the exploration stage since its formation and has not realized significant revenues from its planned principal operations.

Use of estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and

disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ significantly from those estimates.

F-6

CITADEL EXPLORATION, INC.
(AN EXPLORATION STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(AUDITED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Fair value of financial instruments

Fair value estimates discussed herein are based upon certain market assumptions and pertinent information available to management as of December 31, 2012 and 2011. The respective carrying value of certain on-balance-sheet financial instruments approximated their fair values. These financial instruments include cash, prepaid expenses and accounts payable. Fair values were assumed to approximate carrying values for cash and payables because they are short term in nature and their carrying amounts approximate fair values or they are payable on demand.

Level 1: The preferred inputs to valuation efforts are “quoted prices in active markets for identical assets or liabilities,” with the caveat that the reporting entity must have access to that market. Information at this level is based on direct observations of transactions involving the same assets and liabilities, not assumptions, and thus offers superior reliability. However, relatively few items, especially physical assets, actually trade in active markets.

Level 2: FASB acknowledged that active markets for identical assets and liabilities are relatively uncommon and, even when they do exist, they may be too thin to provide reliable information. To deal with this shortage of direct data, the board provided a second level of inputs that can be applied in three situations.

Level 3: If inputs from levels 1 and 2 are not available, FASB acknowledges that fair value measures of many assets and liabilities are less precise. The board describes Level 3 inputs as “unobservable,” and limits their use by saying they “shall be used to measure fair value to the extent that observable inputs are not available.” This category allows “for situations in which there is little, if any, market activity for the asset or liability at the measurement date”. Earlier in the standard, FASB explains that “observable inputs” are gathered from sources other than the reporting company and that they are expected to reflect assumptions made by market participants.

Fixed assets

The Company records all property and equipment at cost less accumulated depreciation. Improvements are capitalized while repairs and maintenance costs are expensed as incurred. Depreciation is calculated using the straight-line method over the estimated useful life of the assets or the lease term, whichever is shorter. Leasehold improvements include the cost of the Company’s internal development and construction department. Depreciation periods are as follows:

Vehicles	3 years
----------	---------

Website

The Company capitalizes the costs associated with the development of the Company’s website pursuant to ASC Topic 350. Other costs related to the maintenance of the website are expensed as incurred. Amortization is provided over the estimated useful lives of three years using the straight-line method for financial statement purposes. The Company has commenced amortization upon completion of the Company’s fully operational website. Amortization expense for the year ended December 31, 2012 and 2011 totaled \$458 and \$267, respectively.

CITADEL EXPLORATION, INC.
(AN EXPLORATION STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(AUDITED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Stock-based compensation

The Company records stock based compensation in accordance with the guidance in ASC Topic 505 and 718 which requires the Company to recognize expenses related to the fair value of its employee stock option awards. This eliminates accounting for share-based compensation transactions using the intrinsic value and requires instead that such transactions be accounted for using a fair-value-based method. The Company recognizes the cost of all share-based awards on a graded vesting basis over the vesting period of the award.

The Company accounts for equity instruments issued in exchange for the receipt of goods or services from other than employees in accordance with FASB ASC 718-10 and the conclusions reached by the FASB ASC 505-50. Costs are measured at the estimated fair market value of the consideration received or the estimated fair value of the equity instruments issued, whichever is more reliably measurable. The value of equity instruments issued for consideration other than employee services is determined on the earliest of a performance commitment or completion of performance by the provider of goods or services as defined by FASB ASC 505-50.

Earnings per share

The Company follows ASC Topic 260 to account for the earnings per share. Basic earnings per common share (“EPS”) calculations are determined by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per common share calculations are determined by dividing net income by the weighted average number of common shares and dilutive common share equivalents outstanding. During periods when common stock equivalents, if any, are anti-dilutive they are not considered in the computation.

Oil and gas properties

The Company uses the full cost method of accounting for its oil and natural gas properties. Under this method, all acquisition, exploration, development and estimated abandonment costs incurred for the purpose of acquiring and finding oil and natural gas are capitalized within cost centers. At December 31, 2012 and December 31, 2011, the Company had one cost center – California. Unevaluated property costs are excluded from the amortization base until determination of the existence of proved reserves on the respective property or until the requirement for impairment. Unevaluated properties are reviewed at the end of each quarter to determine whether portions of the costs should be reclassified to the full cost pool and thereby subject to amortization. Sales of oil and natural gas properties are accounted for as adjustments to the net full cost pool with no gain or loss recognized, unless the adjustment would significantly alter the relationship between capitalized costs and proved reserves.

Capitalized costs of oil and natural gas properties evaluated as having, or not having, proved reserves are amortized in the aggregate by country using the unit-of-production method based upon estimated proved oil and natural gas reserves. For amortization purposes, relative volumes of oil and natural gas production and reserves are converted at the energy equivalent conversion rate of six thousand cubic feet of natural gas to one barrel of crude oil. Amortizable costs include estimates of future development costs of proved undeveloped reserves. The costs of properties not yet evaluated are not amortized until evaluation of the property. Such evaluations for a well and associated lease rights are made when it is determined whether or not the well has proved oil and natural gas reserves. Other unevaluated properties are evaluated for impairment as of the end of each calendar quarter based upon various factors at the time, including drilling plans, drilling activity, management’s estimated fair values of lease rights by project, and remaining

lives of leases.

F-7

CITADEL EXPLORATION, INC.
(AN EXPLORATION STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(AUDITED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Oil and gas properties (continued)

Capitalized costs of oil and natural gas properties (net of related deferred income taxes) may not exceed a ceiling amount equal to the present value, discounted at 10% per annum, of the estimated future net cash flows from proved oil and natural gas reserves plus the cost of unevaluated properties (adjusted for related income tax effects). Should capitalized costs exceed this ceiling amount, the excess is charged to earnings as an impairment expense, net of its related reduction of the deferred income tax provision. The present value of estimated future net cash flows is computed by applying the twelve-month historical averages of prices of oil and natural gas to estimated future production of proved oil and natural gas reserves as of period-end, less estimated future expenditures (at period-end rates) to be incurred in developing and producing the proved reserves and assuming continuation of economic conditions existing at period-end. The present value of future net cash flows of proved reserves excludes future cash outflows associated with settling asset retirement obligations that have been accrued on the balance sheet.

Effective, January 1, 2013, the Company changed its policy to successful efforts. The Company has evaluated the impact on the prior periods and there are no material changes to the balance sheet as a result of the change in accounting policy. During the quarter ended December 31, 2012, the Company expensed \$6,196 of geological and geophysical costs in anticipation of the change in accounting policy.

In 2013, the Company uses the successful efforts method of accounting for oil and gas exploration costs. Expenditures to acquire mineral interests in oil and gas properties and to drill and equip exploratory wells are capitalized as exploration and evaluation expenditures within. Intangible assets until the well is complete and the results have been evaluated. If, following the evaluation, the exploratory well has not found proved reserves, the previously capitalized costs are evaluated for derecognition or tested for impairment. Geological and geophysical costs and other exploration expenditures are expensed as incurred.

Debt discount

The Company records debt discount as a contra liability account and is presented net of the associated note payable. The discount was amortized over the life on the note payable using the straight line method because the straight line method approximates the effective interest method.

Revenue recognition

The Company recognizes oil and natural gas revenues from our interests in producing wells when production is delivered to, and title has transferred to, the purchaser and to the extent the selling price is reasonably determinable. Gas-balancing arrangements are accounted for using the sales method.

Advertising costs

Advertising costs are anticipated to be expensed as incurred; however there were no advertising costs included in general and administrative expenses for the year ended December 31, 2012 and 2011.

Income taxes

The Company follows ASC Topic 740 for recording the provision for income taxes. Deferred tax assets and liabilities are computed based upon the difference between the financial statement and income tax basis of assets and liabilities

using the enacted marginal tax rate applicable when the related asset or liability is expected to be realized or settled. Deferred income tax expenses or benefits are based on the changes in the asset or liability each period. If available evidence suggests that it is more likely than not that some portion or all of the deferred tax assets will not be realized, a valuation allowance is required to reduce the deferred tax assets to the amount that is more likely than not to be realized. Future changes in such valuation allowance are included in the provision for deferred income taxes in the period of change.

F-8

CITADEL EXPLORATION, INC.
(AN EXPLORATION STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(AUDITED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Income taxes (continued)

Deferred income taxes may arise from temporary differences resulting from income and expense items reported for financial accounting and tax purposes in different periods. Deferred taxes are classified as current or non-current, depending on the classification of assets and liabilities to which they relate. Deferred taxes arising from temporary differences that are not related to an asset or liability are classified as current or non-current depending on the periods in which the temporary differences are expected to reverse.

The Company applies a more-likely-than-not recognition threshold for all tax uncertainties. ASC Topic 740 only allows the recognition of those tax benefits that have a greater than fifty percent likelihood of being sustained upon examination by the taxing authorities. As of December 31, 2012 and 2011, the Company reviewed its tax positions and determined there were no outstanding, or retroactive tax positions with less than a 50% likelihood of being sustained upon examination by the taxing authorities, therefore this standard has not had a material effect on the Company.

The Company does not anticipate any significant changes to its total unrecognized tax benefits within the next 12 months.

The Company classifies tax-related penalties and net interest as income tax expense. As of December 31, 2012 and 2011, \$1,600 and \$1,600 of income tax expense has been incurred.

Recent pronouncements

The Company has evaluated the recent accounting pronouncements through March 2013 and believes that none of them will have a material effect on the company's financial statements.

NOTE 2 – GOING CONCERN

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the recoverability of assets and the satisfaction of liabilities in the normal course of business. As noted above, the Company is in the development stage and, accordingly, has not yet generated revenues from operations. Since its inception, the Company has been engaged substantially in financing activities and developing its business plan and incurring start up costs and expenses. As a result, the Company incurred accumulated net losses from Inception (November 6, 2006) through the period ended December 31, 2012 of (\$827,847). In addition, the Company's development activities since inception have been financially sustained through debt and equity financing.

The ability of the Company to continue as a going concern is dependent upon its ability to raise additional capital from the sale of common stock and, ultimately, the achievement of significant operating revenues. These financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts, or amounts and classification of liabilities that might result from this uncertainty.

NOTE 3 – PREPAID EXPENSES

As of December 31, 2012 and 2011, the Company had prepaid insurance totaling \$9,283 and \$16,664, respectively. The prepaid insurance will be expensed on a straight line basis over the remaining life of the insurance policy. During the years ended December 31, 2012 and 2011, the Company recorded \$21,871 and \$16,664 of insurance expenses.

F-9

CITADEL EXPLORATION, INC.
 (AN EXPLORATION STAGE COMPANY)
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (AUDITED)

NOTE 4 – OIL AND GAS PROPERTIES

The costs capitalized in oil and gas properties as of December 31, 2012 and 2011 are as follows:

	2012	2011
Oil and gas property lease	\$57,830	\$61,984
Exploration	102,003	143,376
	\$159,833	\$205,360

On January 31, 2009, the Company entered into an oil, gas and mineral lease with an unrelated third party. The Company has the right to develop and operate the leased premises for an initial term of three years and the lease will continue as long as the Company continues actual drilling operations and continued development. The initial minimum lease payment of \$20,661 was made upon execution of the lease and the two remaining minimum lease payments of \$20,661 were due on January 31, 2010 and 2011. Additionally, the Company is obligated to pay royalties to the unrelated third party. On oil and gas from all wells on the leased premises, the royalty is a total of 20% of the market value. The royalty payments are due on or before the last day of each month for the preceding month's activity. If the royalty payment is not made timely, the Company will owe a 10% per annum interest on the royalties due.

On February 1, 2012, the Company renegotiated its oil, gas and mineral lease with an unrelated third party for an additional minimum term of two years. The minimum lease payment is \$20,640 per year. The terms of the renegotiated lease are substantially the same as the original lease disclosed above.

On February 22, 2012, the Company sold 40% of its interest in the property disclosed above in exchange for \$350,000. The Company recorded a gain on the sale of the partial interest totaling \$267,856.

During the year ended December 31, 2012, the Company has requested payment from Sojitz for a total of \$9,301 of exploration costs for Sojitz's portion of the costs of which \$2,048 was received during the year ended December 31, 2012. The remaining balance due of \$7,253 is recorded as an other receivable.

NOTE 5 – FIXED ASSETS

Fixed assets as of December 31, 2012 and 2011 are as follows:

	2012	2011
Vehicle	\$23,572	\$-
Less: Accumulated depreciation	(3,273)	-
	\$20,299	\$-

Depreciation expense for the year ended December 31, 2012 was \$3,273.

NOTE 6 – WEBSITE

Edgar Filing: Citadel Exploration, Inc. - Form 10-K

Website as of December 31, 2012 and 2011 are as follows:

	2012	2011
Website	\$1,375	\$1,375
Less: Accumulated amortization	(726)	(267)
	\$649	\$1,108

Amortization expense for the year ended December 31, 2012 was \$459.

F-10

CITADEL EXPLORATION, INC.
 (AN EXPLORATION STAGE COMPANY)
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
 (AUDITED)

NOTE 7 – NOTES PAYABLE

Notes payable consists of the following at:

	December 31, 2012	December 31, 2011
Note payable to an individual, line of credit to borrow up to \$100,000, unsecured, 10% interest, due upon demand	\$55,298	\$55,498
Note payable to an entity for the financing of insurance premiums, unsecured, 13% interest, due March 2012	-	-
Note payable to an entity for the financing of insurance premiums, unsecured, 15% interest, due March 2013	1,746	-
Note payable to an individual, personally guaranteed by shares of the Company which are owned by an officer, 12% interest, due on the earlier of February 2013 or the Company raising in excess of \$1,000,000	250,000	-
Debt discount	(84,517)	
	\$222,527	\$55,498

Interest expense for the years ended December 31, 2012 and 2011 was \$10,744 and \$1,907, respectively.

NOTE 8 – NOTES PAYABLE – RELATED PARTY

Notes payable consists of the following at:

	December 31, 2012	December 31, 2011
Note payable to an entity owned and controlled by an officer, director and shareholder, line of credit to borrow up to \$100,000, unsecured, 4% interest, due upon demand	\$32,240	\$87,000
Note payable to an entity owned and controlled by an officer, director and shareholder, line of credit to borrow up to \$50,000, unsecured, 4% interest, due upon demand	-	28,450
Note payable to an entity owned and controlled by an officer, director and shareholder, line of credit to borrow up to \$50,000, unsecured, 4% interest, due upon demand	-	13,250
Note payable to a director, unsecured, due upon demand, 0% interest	2,750	2,750
	\$34,990	\$131,450

Interest expense for the years ended December 31, 2012 and 2011 was \$2,794 and \$2,504, respectively.

CITADEL EXPLORATION, INC.

(AN EXPLORATION STAGE COMPANY)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(AUDITED)

NOTE 9 – STOCKHOLDERS' EQUITY (DEFICIT)

The Company is authorized to issue 100,000,000 shares of its \$0.001 par value common stock.

On March 2, 2011, the Company effected a 12-to-1 forward stock split of its \$0.001 par value common stock with a record date of March 22, 2011.

All shares and per share amounts have been retroactively restated to reflect the split discussed above.

During the year ended December 31, 2006, the member contributed capital of \$400.

During the year ended December 31, 2007, the member contributed capital of \$40,800.

During the year ended December 31, 2008, the member contributed capital of \$12,000 and received draws totaling \$10,000.

During the year ended December 31, 2009, the member contributed capital of \$43,093.

On May 3, 2011, the Company issued 14,000,000 shares to an individual in exchange for a 100% interest in Citadel Exploration, LLC. As part of the Membership Purchase Agreement the former officers and directors agreed to cancel 7,696,000 shares of common stock. On May 3, 2011, the transaction was closed and 100% interest in Citadel Exploration, LLC was acquired by the Company. For accounting purposes, the acquisition of Citadel Exploration, LLC by the Company has been recorded as a reverse acquisition of a public company and recapitalization of Citadel Exploration, LLC based on the factors demonstrating that Citadel Exploration, LLC represents the accounting acquirer. The historic financial statements of Citadel Exploration, LLC and related entities, while historically presented as an LLC equity structure, have been retroactively presented as a corporation for comparability purposes. The Company changed its business direction and is now an oil and gas company.

On May 20, 2011, the Company sold 62,500 shares of common stock for cash of \$50,000. As of June 30, 2011, the Company issued 20,000 shares of common stock. As of December 31, 2011, the remaining 42,500 shares have not been issued and have been recorded to stock payable.

On October 12, 2011, the Company issued 100,000 shares of common stock for services totaling \$80,000 to be performed over a period of one year. The shares were valued according to the fair value of the common stock

During January 2012, the Company received donated capital of \$980 from an officer of the Company.

During May 2012, the Company issued 42,500 shares of common stock to an investor for \$34,000 in cash received during the year ended December 31, 2011. Upon issuance of the common stock, the Company reduced the entire balance of stock payable to \$0.

During July 2012, an entity owned and controlled by an officer and director of the Company forgave accounts payable totaling \$50,953 and was recorded to additional paid in capital.

Edgar Filing: Citadel Exploration, Inc. - Form 10-K

During the three months ended September 30, 2012, the Company agreed to issue a total 250,500 shares for consulting services rendered totaling \$48,430. In November 2012, the shares of common stock were issued.

During September 2012, the Company issued 4,000,000 stock options to executives as part of their employment agreements. The fair value of the stock options totaled \$149,994.

F-12

CITADEL EXPLORATION, INC.
(AN EXPLORATION STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(AUDITED)

NOTE 9 – STOCKHOLDERS’ EQUITY (DEFICIT) (CONTINUED)

During September 2012, the Company issued 2,000,000 shares of common stock to an investor for \$80,000 in cash.

During November 2012, the Company issued 500,000 warrants to a lender in conjunction with a promissory note. The fair value of the warrants totaled \$217,330.

NOTE 10 – STOCK OPTION PLAN

On September 1, 2012, the Board of Directors of the Company ratified, approved, and adopted a Stock Option Plan for the Company allowing for the grant of up to 10,000,000 shares of common stock or stock options to acquire common shares. In the event an optionee ceases to be employed by or to provide services to the Company for reasons other than cause, any Stock Option that is vested and held by such optionee may be exercisable within up to thirty days after the effective date that his position ceases. No Stock Option granted under the Stock Option Plan is transferable. Any Stock Option held by an optionee at the time of his death may be exercised by his estate within six months of his death or such longer period as the Board of Directors may determine.

As approved by the Board of Directors, on September 4, 2012, the Company granted 4,000,000 stock options to two officers of the Company at \$0.20 per share for terms of seven years. Of the total stock options, 1,000,000 vested immediately and the remaining vest equally over the next 3 years at the anniversary date of the employment agreements. The total fair value of these options at the date of grant was estimated to be \$599,974 and was determined using the Black-Scholes option pricing model with an expected life of 7 years, a risk free interest rate of 1.01%, a dividend yield of 0% and expected volatility of 254%. During year ended December 31, 2012, \$149,994 was recorded as a stock based compensation expense.

The following is a summary of the status of all of the Company’s stock options as of December 31, 2012 and changes during the period ended on that date:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Life (Years)
Outstanding at January 1, 2012	-	\$ 0.00	-
Granted	4,000,000	\$ 0.20	6.67
Exercised	-	\$ 0.00	-
Cancelled	-	\$ 0.00	-
Outstanding at December 31, 2012	4,000,000	\$ 0.20	6.67
Exercisable at December 31, 2012	1,000,000	\$ 0.20	6.67

NOTE 11 – WARRANTS

On November 15, 2012, the Company granted 500,000 stock warrants to a lender at \$0.55 per share for terms of two years. The total fair value of these warrant at the date of grant was estimated to be \$217,330 and was determined using the Black-Scholes option pricing model with an expected life of 2 years, a risk free interest rate of 0.28%, a dividend

yield of 0% and expected volatility of 302%. During year ended December 31, 2012, \$132,813 was recorded amortization of debt discount and included in interest expense.

F-13

CITADEL EXPLORATION, INC.
(AN EXPLORATION STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(AUDITED)

NOTE 11 – WARRANTS (CONTINUED)

The following is a summary of the status of all of the Company's stock warrants as of December 31, 2012 and changes during the period ended on that date:

	Number of Warrants	Weighted-Average Exercise Price	Weighted-Average Remaining Life (Years)
Outstanding at January 1, 2012	-	\$ 0.00	-
Granted	500,000	\$ 0.55	1.87
Exercised	-	\$ 0.00	-
Cancelled	-	\$ 0.00	-
Outstanding at December 31, 2012	500,000	\$ 0.55	1.87
Exercisable at December 31, 2012	500,000	\$ 0.55	1.87

NOTE 12 – RELATED PARTY TRANSACTIONS

On January 1, 2012, the Company entered into a consulting and rental agreement with an entity owned and controlled by an officer, director and shareholder. The consulting fees are fixed at \$10,000 per month and rent is up to \$25,000 per month. The agreement automatically expires on July 1, 2013 unless the parties mutually agree to extend the term. The Company will have a one-time option to extend the term of the agreement by compensating the related party with a renewal bonus of \$500,000 at which time the agreement would continue for an additional 18 months at the same terms and conditions of the agreement. During the year ended December 31, 2012, the Company and the entity mutually agreed to terminate the consulting and rental agreement. During the year ended December 31, 2012, the Company recorded consulting fees of \$60,000 and rent expense of \$62,930. On July 1, 2012, the parties agreed to mutually terminate the agreement. The entity agreed to forgive \$50,953 of accounts payable related to the agreement and was recorded to additional paid in capital.

During the year ended December 31, 2012, the Company repaid a total of \$122,700 to reduce balances due under notes payable to entities owned and controlled by an officer, director and shareholder.

On July 31, 2012, the Company purchased a vehicle from the CEO of the Company for \$23,572 and allowed the Company up to one year to repay the loan. The loan bears 0% interest. During the year ended December 31, 2012, the Company paid a total of \$23,572 of the note payable. As of December 31, 2012, the balance owed is \$0.

On September 1, 2012, the Company entered into a three year employment agreement with its CEO. The annual salary for the first year is \$120,000, then in the second year increases to \$180,000 and in the third year it increases to \$240,000. Additionally, the officer received 2,000,000 stock options. During the year ended December 31, 2012, the Company recording executive compensation totaling \$114,997.

On September 1, 2012, the Company entered into a three year employment agreement with its CFO. The annual salary for the first year is \$120,000, then in the second year increases to \$180,000 and in the third year it increases to \$240,000. Additionally, the officer received 2,000,000 stock options. During the year ended December 31, 2012, the

Company recording executive compensation totaling \$114,997.

F-14

CITADEL EXPLORATION, INC.
(AN EXPLORATION STAGE COMPANY)
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(AUDITED)

NOTE 12 – RELATED PARTY TRANSACTIONS (CONTINUED)

During November 2012, the Company paid \$6,196 to The Nahabedian Group for reimbursement of geophysical survey on potential future locations. The Nahabedian Group is an entity owned and controlled by the CEO of the Company. This amount was initially capitalized under exploration costs, since the Company followed full cost method. During the year ended December 31, 2012, the amount was reclassified as expense and is included in general and administrative expenses to account for change in accounting policy to successful efforts method.

NOTE 13 – SUBSEQUENT EVENTS

During February 2013, the Company raised a total of \$1,424,000 in cash through the sale of 4,186,000 shares of common stock at a price of \$0.34 per share.

During February 2013, the Company repaid \$15,000 of notes payable – related party.

On February 19, 2013, the Company settled \$250,000 of principal on a note payable and the entire balance of accrued interest for 750,000 shares of common stock and \$2,500 in cash.

On February 26, 2013, the Company settled \$55,298 of principal on a note payable and the entire balance of accrued interest for 162,640 shares of common stock.

On February 28, 2013, the Company issued 240,000 shares of common stock for accounting services.

On February 28, 2013, the Company issued 50,000 shares of common stock for legal services.

On February 28, 2013, the Company issued 30,000 shares of common stock for marketing services.