

Citadel Exploration, Inc.
Form 10-K
April 16, 2015

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, 2014

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF
1934
For the Transition Period from _____ to _____

Commission file number 000-54369

-

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, CA 92663

(Address of principal executive offices)

(949) 612-8040

(Registrant's telephone number, including area code)

Securities registered pursuant to

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

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 is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller 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)	Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange 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 28, 2014 (the last business day of the registrant's most recently completed second fiscal quarter) was \$17,263,950 based on a share value of \$0.55.

The number of shares of Common Stock, \$0.001 par value, outstanding on April 15, 2015 was 32,814,000 shares.

DOCUMENTS INCORPORATED BY REFERENCE: None.

CITADEL EXPLORATION, INC.

FOR THE FISCAL YEAR ENDED

DECEMBER 31, 2014

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on Form 10-K

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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:

- our ability to diversify our operations;
- exploration risks such as drilling unsuccessful wells;
- our ability to attract key personnel;
- our ability to operate profitably;
- our ability to efficiently and effectively finance our operations, and/or purchase orders;
- inability to achieve future sales levels or other operating results;
- inability to raise additional financing for working capital;
- inability to efficiently manage our operations;
- the inability of management to effectively implement our strategies and business plans;
- the unavailability of funds for capital expenditures and/or general working capital;
- 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;
- deterioration in general or regional economic conditions;
- changes in U.S. GAAP or in the legal, regulatory and legislative environments in the markets in which we operate;
- 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 expressions.

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.

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

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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 of a written request to us at Citadel Exploration, Inc., 417 31st Street Unit A, Newport Beach, California 92663.

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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 our acquisition of CEL, we 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 the oil and gas industry in California.

Business of Citadel

Citadel is an energy company engaged in the exploration and development of oil and natural gas properties. Our properties are located in the Salinas and San Joaquin Basins of 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 build value in the Company through acquisition

of gas and oil leases with significant upside potential, successful exploration and exploitation and the efficient development of these assets.

Our Projects

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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 to 14 gravity API) oil in place. A well that was drilled and cored extensively by Chevron in 1976 (Tannehill Ranch Core hole #9) showed the oil is trapped in highly porous and permeable basal Pliocene sands at a 300 foot to 500 foot depth with 300 feet of clay stone cap rock. This accumulation is a strong analog to another discovery made by the founders of Citadel at Northwest San Ardo, albeit at a shallower depth.

Citadel currently owns a 100% working interest at Project Indian, in July of 2014 Citadel ended its prior joint venture with Sojitz Energy Ventures. There is a 20% royalty on the property owned by Vintage Petroleum, a wholly owned subsidiary of Occidental Petroleum Inc. In November of 2014 Occidental Petroleum Inc. spun off its California assets into a new public company called California Resources Corporation, which is listed on the New York Stock Exchange under the ticker CRC. CRC is now the mineral owner at Project Indian.

In January of 2014, Citadel drilled and completed the first well at Project Indian, the Indian #1-15, and conducted a successful steam cycle in June of 2014. The Indian #1-15 then produced 3 to 7 barrels per day over several weeks before production halted because the well was shut-in by an order of the Superior Court of the State of California-County of Monterey entitled *Center for Biological Diversity v. San Benito County* Case no. M123956 (hereinafter the “Case”).

In the Case, the Center for Biological Diversity, a non-governmental entity, petitioned the Court over the approval of Project Indian by the County of San Benito on a unanimous, 5-0 vote. Specifically, it argued that Project Indian required an Environmental Impact Report and not a Mitigated Negative Declaration which was the standard of environmental due diligence required by the County before its unanimous approval of the Project. The Court approved the petition in a judgment entered on September 4, 2014, and ruled that Citadel was required to obtain an environmental impact report before commencing further at Project Indian .

Then, on November 4, 2014 Measure J was passed by a majority of participating, registered voters in the County of San Benito. Measure J bans hydraulic fracturing and other stimulation techniques defined as “high intensity petroleum operations” by the Measure, including cyclic steam injection. Citadel believes the passing of Measure J constitutes a regulatory taking of property and is preempted by the State of California. At this time there is no certainty that we will be able to develop the Indian Oil Field.

PROJECT YOWLUMNE

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In May 2013, we leased approximately 2,800 acres from AERA Energy, LLC (“Aera”). This acreage has been mapped using a combination of both 2D and 3D seismic, and is in close proximity to the Yowlumne oil field in Kern County, California. The Company is obligated to pay a 20% royalty to Aera. In August of 2013, the Company entered into an agreement to sell 55% of the interest in the Yowlumne lease, recouping approximately 85% of its cost, while retaining a 25% interest in the lease and operatorship. In July of 2014 the Company ended its joint venture with Sojitz Energy Ventures retaining Sojitz’s 55% interest in the Yowlumne lease, therefore increasing Citadel’s ownership to 75% in the Yowlumne lease.

Additionally, as part of this transaction, the Company retained 100% interest in the Yowlumne #2-26 well, and the 160 acres surrounding the well bore. The Yowlumne #2-26 was first drilled in 2008 under supervision of Citadel CEO, Armen Nahabedian, during his previous tenure with his family’s oil company. Although the well tested oil at that time, the well was left idle for 5 years as lease issues prevented operations on the well until the appropriate curative measures could be taken.

In December of 2014, Citadel began a work-over on the Yowlumne #2-26 well including installation of a new pump in February of 2015. The well has been producing approximately 20- 25 barrels per day (32 degree API quality) since the beginning of March. Citadel is in the final stages of the CEQA process to permit two additional exploration wells on the Yowlumne acreage and expects to receive those drilling permits in the second quarter of 2015, with drilling to commence in the third quarter of 2015. Both of these exploration wells will be targeting the Stephens Sands at a depth of 12,000 to 15,000 feet. Citadel currently has a 75% working interest in these exploration prospects and is the operator.

Oil and Natural Gas Industry Overview

Oil and natural gas prices have been extremely volatile over the past twelve months and are currently at five year lows.. 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 volatile for the foreseeable future. We believe that this presents both a tremendous challenge and opportunity for our Company to grow quickly. We have assembled an experienced 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

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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 Properties. 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

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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, well stimulation techniques such as hydraulic fracturing, acid matrix stimulation, cyclic steam injection 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.

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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.

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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

We currently have two full-time employees, our Chief Executive Officer and our Chief Financial Officer. 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, legal 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
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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.
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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.
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Basin	
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A depressed area where sediments have accumulated during geologic time and considered to be prospective for oil and gas deposits.

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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.
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.

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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.

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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.

Proved Reserves

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/ecfrlinks.shtml>

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.

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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.

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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 2008 and 2009 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.

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.

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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.

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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.

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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.

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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** (OTC**QB**), 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** (OTC**QB**), 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 OTC**QB**. 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.

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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 received notice on or about July 10, 2013 that the Center for Biological Diversity (“CBD”) had filed a law suit against the County of San Benito regarding the approval of Project Indian which is described more fully, above, as the “Case”. The Board of Supervisors voted 5-0 in favor of our application to drill 15 exploration wells on our Project Indian lease. The Court approved the petition in a judgment entered on September 4, 2014, and ruled that Citadel was required to obtain an environmental impact report before commencing Project Indian. Thereafter, the Court awarded the petitioner \$347,969 as attorney's fees and costs against

the County of San Benito and Citadel, jointly and severally. The Company is in the process of appealing this decision. At this time management is unable to estimate the minimum liability that may be incurred if any as a result of the outcome of this appeal and therefore has made no provision in the financial statements for liability related to this case.

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On November 4, 2014 voters in the County of San Benito passed Measure J which bans hydraulic fracturing and other stimulation techniques defined as “high intensity petroleum operations” by the Measure, including steam injection. The initiative was passed by a count of 8,034 to 5,605. In advance of the initiative passing, the County preemptively passed an ordinance allowing for exemptions from the application of the Measure in the event the Measure would result in a taking. A regulatory taking is a situation in which a government regulation limits the uses of private property to such a degree that the regulation effectively deprives the property owners of economically reasonable use or value of their property right to such an extent that it deprives them of utility or value of that property right, even though the regulation does not formally divest them of title to it. Accordingly, Citadel Exploration Inc. will provide the County of San Benito the ability to compensate the company for the diminished value at the Indian Oil Field based on the reasonable Unrisked Resource Potential the property would ultimately yield, or allow Citadel to proceed with full field development and steam injection under the exemption ordinance.

On February 27th, 2015, Citadel sued the County of San Benito on the basis that Measure J and its enabling ordinance are preempted by the law of the State of California. Specifically, the complaint alleges that the power and authority to regulate the down-hole operations of oil and gas exploration and production is vested exclusively in the Division of Oil, Gas, and Geothermal Resources of the Department of Conservation. It further alleges that the County’s Measure and its ordinance are preempted by State law as the regulation of down-hole operations is exclusively a State function, and that the County lacks the power and authority to regulate down-hole operations. On April 3, 2015 Citadel dismissed the complaint, without prejudice. At this time Citadel has reserved its rights, with respect to the Indian Oil Field, including claims for inverse condemnation.

ITEM 4. MINE SAFETY DISCLOSURES

None

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(table of contents)**PART II****ITEM 5. MARKET FOR COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND SMALL BUSINESS 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.

	2014		2013	
	BID		BID	
	PRICES		PRICES	
	High	Low	High	Low
1 st Quarter	\$0.50	\$0.32	\$0.40	\$0.25
2 nd Quarter	\$0.55	\$0.31	\$1.50	\$0.15
3 rd Quarter	\$0.45	\$0.10	\$1.22	\$0.42
4 th Quarter	\$0.25	\$0.10	\$0.89	\$0.46

 Holders of Common Stock

As of April 14, 2015, we had approximately 81 stockholders of record of the 32,814,000 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:

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- 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

On September 1, 2012, we adopted the 2012 Stock Incentive Plan. We have reserved for issuance an aggregate of 10,000,000 shares of common stock under our 2012 Stock Incentive Plan. To date, 4,800,000 options and no shares of common stock have been granted under this plan.

Recent Sales of Unregistered Securities

In December 2014, the Company approved the issuance of 500,000 common stock shares for engineering, legal, accounting and marketing services performed in the fourth quarter of 2014.

In March of 2015, the Company approved the issuance of 1,400,000 common stock shares and issued 25,000 shares recorded as a stock payable at December 31, 2014, for the conversion of a \$100,000 promissory note, plus accrued interest of \$2,164 and an additional capital investment of \$107,835, all at \$0.15 per share.

In March of 2015, the Company issued 25,000 shares of common stock to settle the stock payable of \$2,250 recorded as of December 31, 2014.

Issuer Purchases of Equity Securities

The Company did not repurchase any of its equity securities during the fourth quarter ended December 31, 2014.

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 which was 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.

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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 and San Joaquin Basins 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.

In December of 2014, Citadel began a work-over on the Yowlumne #2-26 well including installation of a new pump in February of 2015. The well has been producing approximately 20- 25 barrels per day (32 degree API gravity) since the beginning of March 2015. Citadel is in the final stages of the CEQA process to permit two additional exploration wells on the Yowlumne acreage and expects to receive those drilling permits in the second quarter of 2015, with drilling to commence in the third quarter of 2015. Both of these exploration wells will be targeting the Stephens Sands at a depth of 12,000 to 15,000 feet. Citadel currently has a 75% working interest in these exploration prospects and is the operator.

Currently at Project Indian, we have drilled and completed our first well (Indian #1-15). On May 5, 2014 we received our permit from the California Division of Oil, Gas & Geothermal Resources for steam injection at Project Indian. On July 11th, the Company announced it had ended its joint venture with Sojitz Energy Ventures at Project Indian. As part of the agreement, Citadel now owns 100% of the working interest at Project Indian. On August 13, 2014 the Company announced that it had completed a successful steam cycle on the Indian #1-15. The cycle consisted of injected approximately 3,600 barrels of steam. The Company then allowed the well to soak for approximately 7 days. The well was then turned onto production. After recovering approximately 50% of the injected steam volume, the well began to produce oil. Oil production gradually increased and produced in a range of 3-7 barrels per day. The oil produced has been tested and is 11.6 degrees API in nature, with lower viscosity than traditional heavy oil. This lower viscosity indicates that the oil is mobile at room temperature, which we believe improves the economics of this oil field.

On September 4, 2014, a judgment was entered that Citadel was required to obtain an environmental impact report before commencing Project Indian. This ruling will require the preparation of an Environmental Impact Report prior to further drilling and production at the Indian Oil Field. As such the Company is working diligently with its engineers

on the full field development plan for Project Indian, which will require several hundred wells for full field development.

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On November 4, 2014 voters in the County of San Benito passed Measure J which bans hydraulic fracturing and other stimulation techniques defined as “high intensity petroleum operations” by the Measure, including cyclic steam injection. The initiative was passed by a count of 8,034 to 5,605. In advance of the initiative passing, the County preemptively passed an ordinance allowing for exemptions from the application of the Measure in the event the Measure would result in a taking. A regulatory taking is a situation in which a government regulation limits the uses of private property to such a degree that the regulation effectively deprives the property owners of economically reasonable use or value of their property right to such an extent that it deprives them of utility or value of that property right, even though the regulation does not formally divest them of title to it. Accordingly, Citadel Exploration Inc. will provide the County of San Benito the ability to compensate the company for the diminished value at the Indian Oil Field based on the reasonable Unrisked Resource Potential the property would ultimately yield, or allow Citadel to proceed with full field development and cyclic steam injection under the exemption ordinance.

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 exploration stage and, accordingly, has not generated any significant revenues from operations. As shown on the accompanying financial statements, the Company has incurred a net loss of \$1,609,957 for the year ended December 31, 2014. 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 year ended December 31, 2014 we generated minimal revenue. During the year ended December 31 2013, we generated \$9,223 in revenue from oil sales.

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Operating expenses totaled \$1,522,508 during the year ended December 31, 2014 as compared to \$1,189,375 in the prior year ended December 31, 2013. Operating expenses primarily consisted of executive compensation, professional fees and general and administrative expenses in the year ended December 31, 2014.

General and administrative fees increased \$31,897 from the year ended December 31, 2013 to the year ended December 31, 2014. This increase was primarily due to insurance, marketing and meals and entertainment expenses.

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Professional fees decreased \$62,898 from the year ended December 31, 2013 to the year ended December 31, 2014. The decrease was primarily due to a decrease in services provided to the Company for accounting, consulting and legal.

Executive compensation increased \$342,899 from the year ended December 31, 2013 to the year ended December 31, 2014. The increase was primarily due to the fair value of the vested stock options and monthly salary as part of the employment agreements with two officers, and the value of the 800,000 stock options that were granted June 18, 2014 to the Board of Directors.

Liquidity and Capital Resources

The Company has not yet established a capital budget for 2015. Given the current state of depressed oil prices, the Company is currently evaluating multiple acquisitions. If or when the Company makes an acquisition, at that time we will establish our capital budget for the balance of 2015. We may revise our capital budget during the year as a result of acquisitions and/or drilling outcomes or significant changes in cash flows.

As of December 31, 2014, we had \$312,274 of current assets, of this amount \$270,298 was cash. 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 years ended December 31, 2014 and 2013:

	Years Ended	
	December 31,	
	2014	2013
Net cash used in operating activities	\$(615,675)	\$(606,389)
Net cash used in investing activities	(682,313)	(1,227,189)
Net cash provided by financing activities	1,165,637	2,123,647
Net increase (decrease) in cash	(132,351)	290,069
Cash, beginning of year	402,649	112,580
Cash, end of year	\$270,298	\$402,649

Investing activities

Net cash used in investing activities was \$682,313 for the year ended December 31, 2014. The net cash used in investing activities consisted primarily of payments for drilling expenses on oil and gas properties.

Financing activities

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Net cash provided by financing activities for the year ended December 31, 2014 was \$1,165,637. The net cash provided by financing activities consisted of cash provided from a strategic financing agreement totaling \$300,000, the issuance of two notes payable for \$670,268, proceeds from sale the of common stock of \$272,000, net of cash payments totaling \$76,631.

As of December 31, 2014, 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 projects, 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.

Contractual Obligations

An operating lease for rental office space was entered into beginning March 1, 2013 for two years at \$2,150 per month. The original lease was amended to include additional space at a price of \$1,100 per month for the same term. For the year ended December 31, 2015, the Company is obligated to pay \$6,500 to satisfy the terms of the lease.

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

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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 significant 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-20 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.

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ITEM 9A. 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 not designed at a reasonable assurance level and are not 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.

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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, 2014.

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.

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[\(table of contents\)](#)**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.

<u>Name</u>	<u>Age</u>	<u>Title</u>	<u>Director Since</u>
Armen Nahabedian	36	Chief Executive Officer, President & Director	8/9/2011
Daniel Szymanski	52	Chairman of the Board	5/3/2011
Philip J. McPherson	40	Chief Financial Officer, Secretary, Treasurer & Director	9/1/2012
Jim Walesa	54	Director	9/1/2014
James Borgna	36	Director	5/3/2011

Armen Nahabedian, 36, 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, 52, 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 degree in Geology from the University of Wisconsin and a Masters in Geophysics from Purdue.

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Philip J. McPherson, 40, 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.

James Walesa, 54 Director: Mr. Walesa has more than three decades of experience in financial services with an emphasis on the energy industry. He started in 1982 with First Investors (FIC) as a registered representative in Chicago and became the youngest vice president in firm history at age 26. He left FIC to form Asset Management & Protection Corporation (AMPC) in May 1988. AMPC started from scratch and today manages over \$500 million. Mr. Walesa entered the energy industry in 1992 in the Permian Basin. He and some of his clients were original investors in Basic Energy Services (BAS: NYSE) and Southwest Royalties, now part of Clayton Williams Energy (CWE: NYSE). He is also a founding member of the Offshore Energy Center in Galveston, Texas. Mr. Walesa and AMPC clients continue to provide startup capital for energy related companies and was an original investor in Citadel’s first offering. Mr. Walesa previously served on the board of NASDAQ-traded Financial Assurance and several private companies. He was the Chicago Chairman for the National Multiple Sclerosis Society and is a member of the Alzheimer’s Alois Society in recognition of his leadership and support of the Alzheimer’s Association to prevent and cure dementia related disease.

James Borgna, 36, 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.

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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.

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

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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

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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, 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. As of the date of the salary increase, the CEO and CFO have deferred payment of approximately \$5,000 per month of salary during the second year of the contract and \$10,000 per month of salary during the third year of the contract. The CEO and CFO are also entitled to quarterly and annual bonuses upon reaching mutually agreeable objectives set by Employer and Employee. The CEO and 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 earned by our Executive Officers but does not account for deferred compensation as discussed above, for the last two fiscal years ended December 31, 2014 and 2013.

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SUMMARY COMPENSATION TABLE									
Name and Principal Positions	Year	Salary (\$)	Bonus (\$)	Stock Awards (\$)	Option Awards (\$)	Non-Equity Incentive Plan Compensation (\$)	Change in Pension Value and Nonqualified Deferred Compensation Earnings (\$)	All Other Compensation (\$)	Total (\$)
Armen Nahabedian,	2014	200,000	-0-	-0-	56,944	-0-	-0-	-0-	256,944
Chief Executive Officer, President, and Director ⁽¹⁾	2013	140,000	-0-	-0-	74,997	-0-	-0-	-0-	214,997
Philip McPherson	2014	200,000	-0-	-0-	56,944	-0-	-0-	-0-	256,944
Chief Financial Officer, Secretary, Treasurer, and Director ⁽²⁾	2013	140,000	-0-	-0-	74,997	-0-	-0-	-0-	214,997

(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

Pursuant to the terms of the 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

On June 18, 2014 the Board of Directors approved the granting of 200,000 stock options at \$0.55 per share for a term of seven years to four of the five board members. These stock options were granted under the current 2012 Stock Incentive Plan for up to 10,000,000 shares. Currently the Company has granted 4,800,000 shares under this plan.

Director Compensation

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As a result of having limited capital resources we do not currently have an established compensation package for our board members. Therefore the Board of Directors approved issuing 200,000 stock options at \$0.55 per share in 2014 as compensation.

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 15, 2015 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 32,814,000 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	4,421,500	13.0 %
Common	Daniel L. Szymanski, Chairman of the Board	250,000	1.0 %
Common	Philip J. McPherson, CFO & Director	2,030,000	6.0 %
Common	James Walesa, Director(2)	2,059,364	6.0 %
Common	James Borgna, Director	200,000	0.9 %
Common	Vahagn Nahabedian	4,000,000	12.0 %
	All Beneficial Owners as a Group	12,960,864	39.0 %

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 3rd St. Unit A, Newport Beach, CA 92663

- (2) Includes 1,425,000 shares owned by Cibolo Creek Partners of which Mr. Walesa is a member.

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

Transactions with Related Persons

During the year ended December 31, 2014, the Company made the following purchases from entities considered related parties; \$39,199 for oil field equipment and services from KVOS, LLC. KVOS is owned by James Borgna, who is a member of our Board of Directors.

In December 2014, we entered an agreement with Jim Walesa and Cibolo Creek Partners to fund \$300,000 towards the Yowlumne #2-26 recompletion. In this agreement Mr. Walesa and Cibolo Creek will receive 75% of the net revenue after expenses, until they have received \$300,000 in payment. Upon full repayment, Mr. Walesa and Cibolo Creek will receive a 3% royalty on the well. Mr. Walesa is currently on the Board of Directors of Citadel and a member of Cibolo Creek Partners.

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, LLC for the audit of our annual financial statements for the years ended December 31, 2014 and December 31, 2013:

	Fiscal Year Ended	Fiscal Year Ended
	December 31, 2014	December 31, 2013
Audit Fees ⁽¹⁾	\$ 25,500	\$ 22,500
Audit-Related Fees	\$ —	\$ —
Tax Fees	\$ —	\$ —
All Other Fees	\$ —	\$ —
Total	\$ 25,500	\$ 22,500

(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.

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(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.

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Exhibit Index

Exhibit Number	Exhibit Description	Filed herewith	Incorporated by reference	
			Period Form	Filing Exhibit 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
10.4	Bridge Loan Agreement		8-K	10.4 4/4/14
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 X of the Sarbanes-Oxley Act of 2002			
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 X of the Sarbanes-Oxley Act of 2002			
32.1	Certifications of Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	X		
32.2	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	EX. 99.2 11/15/12
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.

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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: /s/Armen Nahabedian

Armen Nahabedian, President

Date: April 15, 2015

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.

<u>Signature</u>	<u>Title</u>	<u>Date</u>
/s/Armen Nahabedian Armen Nahabedian	Chief Executive Officer (Principal Executive Officer), President, and Director	April 15, 2015
/s/Philip J. McPherson Philip J. McPherson	Chief Financial Officer (Principal Financial Officer) Secretary, Treasurer, and Director	April 15, 2015
/s/Daniel L. Szymanski Daniel L. Szymanski	Chairman of the Board	April 15, 2015
/s/James Walesa James Walesa	Director	April 15, 2015

/s/James Borgna Director
James Borgna

April 15,
2015

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CITADEL EXPLORATION, INC.

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AS OF DECEMBER 31, 2014 AND 2013

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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. and subsidiary (“the Company”) as of December 31, 2014 and 2013, and the related consolidated statements of operations, stockholders' equity (deficit), and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these 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 audit 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 audits 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 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. and subsidiary of December 31, 2014 and 2013, and the results of their operations and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

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 incurred losses from operations, which raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 2. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

/s/ De Joya Griffith, LLC

Henderson, NV

April 14, 2015

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(table of contents)**CITADEL EXPLORATION, INC.****CONSOLIDATED BALANCE SHEETS****(AUDITED)**

	December 31, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash	\$270,298	\$402,649
Other receivable	1,209	40,660
Prepaid expenses	35,886	41,589
Product inventory	4,881	4,881
Total current assets	312,274	489,779
Deposits	4,900	4,000
Restricted cash	45,000	45,000
Oil and gas properties	2,042,054	1,373,363
Fixed assets, net	25,927	12,633
Total assets	\$2,430,155	\$1,924,775
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	\$604,558	\$435,332
Accrued interest payable	—	8,316
Notes payable, net	592,533	314,134
Derivative liability	13,308	—
Total current liabilities	1,210,399	757,782
Asset retirement obligation	48,923	31,407
Production payment liability	300,000	—
Total liabilities	\$1,559,322	\$789,189
Stockholders' equity:		
Common stock, \$0.001 par value, 100,000,000 shares authorized, 31,389,000 and 28,949,823 shares issued and outstanding as of December 31, 2014 and December 31, 2013, respectively	31,389	28,950
Additional paid-in capital	4,673,497	3,332,982
Accumulated deficit	(3,836,303)	(2,226,346)
Share subscription payable	2,250	—
Total stockholders' equity	870,833	1,135,586
Total liabilities and stockholders' equity	2,430,155	1,924,775

See accompanying notes to consolidated financial statements.

(table of contents)**CITADEL EXPLORATION, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS****(AUDITED)**

	For the years ended December 31,	
	2014	2013
Revenue	\$19	\$9,223
Operating expenses:		
Lease operating expense	103,883	85,335
Geological and geophysical expense	2,396	6,304
General and administrative	326,991	295,094
Depreciation, amortization and accretion	14,976	8,381
Professional fees	255,173	318,071
Executive compensation	819,089	476,190
Total operating expenses	1,522,508	1,189,375
Other expenses:		
Gain – other	8,316	—
Gain – notes payable settlement	33,545	—
Gain – debt extinguishment	73,573	—
Interest expense	(202,902)	(216,748)
Total other expenses	(87,468)	(216,748)
Net loss before provision for income taxes	(1,609,957)	(1,396,899)
Provision for income taxes	—	1,600
Net loss	\$(1,609,957)	\$(1,398,499)
Weighted average number of common shares outstanding - basic	29,370,223	27,484,783
Net loss per common share - basic	\$(0.05)	\$(0.05)

See accompanying notes to consolidated financial statements.

(table of contents)**CITADEL EXPLORATION, INC.****CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY (DEFICIT)****(AUDITED)**

	Common Shares Shares	Amount	Additional Paid-In Capital	Stock Payable	Accumulated Deficit	Total Equity (Deficit)
Balance, December 31, 2012	22,613,000	\$22,613	\$740,352	—	\$(827,847)	\$(64,882)
Shares issued for cash	5,104,183	5,104	1,913,852	—	—	1,918,956
Shares issued for settlement of notes payable	912,640	913	331,885	—	—	332,798
Shares issued for services	320,000	320	103,149	—	—	103,469
Warrants issued with notes payable	—	—	93,750	—	—	93,750
Stock option compensation	—	—	149,994	—	—	149,994
Net loss	—	—	—	—	(1,398,499)	(1,398,499)
Balance at December 31, 2013	28,949,823	\$28,950	\$3,332,982	—	\$(2,226,346)	\$1,135,586
Shares issued for settlement of notes payable	559,092	559	272,745	—	—	273,304
Shares issued for services	205,085	205	114,133	—	—	114,338
Shares issued for services	875,000	875	182,625	—	—	183,500
Warrants issued with notes payable	—	—	85,325	—	—	85,325
Stock option compensation	—	—	414,487	—	—	414,487
Debt/warrant conversion	800,000	800	271,200	—	—	272,000
Share subscription payable	—	—	—	2,250	—	2,250
Net loss	—	—	—	—	(1,609,957)	(1,609,957)
Balance at December 31, 2014	31,389,000	\$31,389	\$4,673,497	2,250	\$(3,836,303)	\$870,833

See accompanying notes to consolidated financial statements.

[\(table of contents\)](#)**CITADEL EXPLORATION, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS****(AUDITED)**

	For the years ended December 31,	
	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	\$(1,609,957)	\$(1,398,499)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation, amortization and accretion	14,976	8,381
Amortization of debt discount	159,083	178,267
Non cash interest expense	—	22,500
Gain – other	(8,316)	—
Gain – notes payable settlement	(33,545)	—
Gain – debt extinguishment	(73,573)	—
Executive stock based compensation expense	414,487	149,994
Lease abandonment expense	36,162	—
Non-employee stock based compensation	297,388	116,000
Changes in operating assets and liabilities:		—
Decrease (Increase) in other receivable	61,958	(33,407)
Decrease in prepaid expenses	6,153	32,871
Increase in product inventory	—	(4,881)
Increase in deposits	(900)	(4,000)
Increase in accounts payable and accrued liabilities	80,725	332,894
Increase (decrease) in accrued interest payable	39,648	(6,508)
Net cash used in operating activities	(615,675)	(606,389)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchase oil and gas properties	(654,148)	(1,182,189)
Purchase of fixed assets	(28,165)	—
Restricted cash	—	(45,000)
Net cash used in investing activities	(682,313)	(1,227,189)
CASH FLOWS FROM FINANCING ACTIVITIES		
Production advance	300,000	—
Proceeds from sale of common stock, net of costs	272,000	1,906,425
Proceeds from notes payable	670,268	300,000
Repayments of notes payable	(76,631)	(82,778)
Net cash provided by financing activities	1,165,637	2,123,647
NET CHANGE IN CASH	(132,351)	290,069
CASH AT BEGINNING OF YEAR	402,649	112,580
CASH AT END OF YEAR	\$270,298	\$402,649

SUPPLEMENTAL INFORMATION:

Interest paid	\$(2,450)	\$(3,200)
Income taxes paid	\$—		\$(3,200)

NON-CASH INVESTING AND FINANCING ACTIVITIES:

Financing of insurance	\$70,268	\$65,176
Issuance of common stock for settlement of notes payable and accrued interest	\$2,038,452	\$310,298
Asset retirement obligation	\$48,923	\$1,407
Accounts payable related to property exchange	\$97,451	\$—
Other receivables related to property exchange	\$22,507	\$—

See accompanying notes to consolidated financial statements.

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CITADEL EXPLORATION, INC.

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 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, 2014 and 2013, 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.

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CITADEL EXPLORATION, INC.

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, 2014 and 2013. 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:

VehiclesK years

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.

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CITADEL EXPLORATION, INC.

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

Effective, January 1, 2013, the Company changed its policy to successful efforts. The Company evaluated the impact on the prior periods and there were 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 \$23,768 of geological and geophysical costs in anticipation of the change in accounting policy. Under the successful efforts method, oil and gas property costs are initially capitalized with the intent to establish commercially viable reserves. Expenditures to acquire mineral interests in oil and gas properties and to drill and equip exploratory wells are capitalized 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.

The Company is required to make estimates and judgments about future events and circumstances regarding the future economic viability of extracting the underlying resources. Changes to project economics, resource quantities, expected production techniques, unsuccessful drilling, expired mineral leases, production costs and required capital expenditures are important factors when making this determination. To the extent a judgment is made, that the underlying reserves are not viable, the oil and gas property costs will be impaired and charged to net earnings.

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CITADEL EXPLORATION, INC.

Notes to CONSOLIDATED Financial Statements

(AUDITED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and cash equivalents

The Company considers all highly liquid instruments with maturity of three months or less at the time of issuance to be cash equivalents.

Concentrations of credit risk

Financial instruments that subject the Company to credit risk could consist of cash balances maintained in excess of federal depository insurance limits. The Company maintains its cash and cash equivalent balances with high credit quality financial institutions. At times, cash and cash equivalent balances may be in excess of Federal Deposit Insurance Corporation limits. To date, the Company has not experienced any such losses.

Restricted cash

The Company has two bonds at financial institutions to meet financial bonding requirements in the state of California. As of December 31, 2014, restricted cash totaled \$45,000.

Debt discount

The Company records debt discount as a contra liability account and is presented net of the associated note payable. The discount is 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.

Asset retirement obligation

ARO reflects the estimated present value of the amount of dismantlement, removal, site reclamation and similar activities associated with the Company's oil and natural gas properties. Inherent in the fair value calculation of the ARO are numerous assumptions and judgments including the ultimate settlement amounts, inflation factors, credit adjusted discount rates, timing of settlement and changes in the legal, regulatory, environmental and political environments.

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.

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 net operating loss carryforward for the year ended December 31, 2014 is \$3,915,575 and the deferred tax asset is \$1,330,049. The Company maintains a full valuation allowance for the deferred tax asset of \$1,330,049.

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CITADEL EXPLORATION, INC.

Notes to CONSOLIDATED Financial Statements

(AUDITED)

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

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, 2014 and 2013, 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, 2014 and 2013, \$0 and \$1,600 of income tax expense has been recorded.

Long-lived Assets

In accordance with the Financial Accounting Standards Board ("FASB") Accounts Standard Codification (ASC) ASC 360-10, "Property, Plant and Equipment," the carrying value of intangible assets and other long-lived assets is reviewed on a regular basis for the existence of facts or circumstances that may suggest impairment. The Company recognizes impairment when the sum of the expected undiscounted future cash flows is less than the carrying amount of the asset. Impairment losses, if any, are measured as the excess of the carrying amount of the asset over its estimated fair value.

Recent pronouncements

The Company has evaluated the recent accounting pronouncements through March 2015 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 exploration stage and, accordingly, has not yet generated significant 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 a net loss for period ended December 31, 2014 of \$1,609,957. In addition, the Company's exploration 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, 2014 and 2013, the Company had prepaid insurance totaling \$23,849 and \$33,104 respectively. The prepaid insurance will be expensed on a straight line basis over the remaining life of the insurance policies. During the years ended December 31, 2014 and 2013, the Company recorded \$54,702 and \$47,681 of insurance expenses. As of December 31, 2014 and 2013, the Company had prepaid expenses of \$7,037 and \$3,485 respectively before services were rendered. As of December 31, 2014 and 2013, the Company had a prepaid deposit of \$5,000 and \$5,000 respectively for leased office space.

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CITADEL EXPLORATION, INC.

Notes to CONSOLIDATED Financial Statements

(AUDITED)

NOTE 4 – OIL AND GAS PROPERTIES

The costs capitalized in oil and gas properties as of December 31, 2014 and 2013 are as follows:

	2014	2013
Exploration \$	2,042,054	\$ 1,373,363

Project Indian

On January 31, 2009, the Company entered into an oil, gas and mineral lease in San Benito County, California with an unrelated third party for the right to develop and operate the leased premises for an initial term of three years. The lease will continue as long as the Company continues actual drilling operations and continued development. The Company is obligated to pay royalties to the unrelated third party on oil and gas from all wells on the leased premises, and the royalty is a total of 20% of the market value. On February 1, 2012, the Company renegotiated this oil, gas and mineral lease for an additional minimum term of two years. The terms of the renegotiated lease are substantially the same as the original lease disclosed above. On February 1, 2013, the Company paid the final amount due to the mineral owner for this lease.

On February 22, 2012, the Company sold 40% of its interest in the property disclosed above in exchange for \$350,000 to its joint venture partner. The Company recorded a gain on the sale of the partial interest totaling \$267,856. Drilling commenced on this property in January 2014, the Indian #1-15 was drilled and cased with Citadel paying 100% of the costs.

On May 5, 2014 the Company received its steam injection permit from DOGGR, and then commenced cyclic steam operations in June.

On July 11, 2014, the Company announced that it had ended its joint venture with Sojitz Energy Ventures. In connection with the termination of the joint venture the Company entered into an agreement with Sojitz to exchange working interests in various properties. Under the agreement the Company agreed to transfer its ownership interest in the Tejon project in exchange for Sojitz's working interest in the Indian and Yowlumne projects. After the transfer the Company owns 100% of the working interest in project Indian and 80% of the working interest at Yowlumne. In

addition to the transfer of working interests in the properties the Company and Sojitz agreed to settle certain amounts recorded as a receivable from Sojitz and a payable to Sojitz in the amounts of \$22,507 and \$97,451, respectively. In connection with this transaction the Company incurred legal cost and fees related to land leases totaling \$41,687. As a result of the above exchange of assets, the Company recorded a net reduction of oil and gas properties in the amount of \$33,297. This exchange of assets was accounted for as a nonmonetary exchange of assets in accordance with ASC 845.

On August 13, 2014 the Company announced that it had completed a successful steam cycle on the Indian #1-15. The cycle consisted of injected approximately 3,600 barrels of steam. The Company then allowed the well to soak for approximately 7 days. The well was then turned onto production. After recovering approximately 50% of the injected steam volume, the well began to produce oil. Oil production has gradually increased and produced in a range of 3-7 barrels per day. The oil produced has been tested and is 11.6 degrees API in nature, with lower viscosity than traditional heavy oil. This lower viscosity indicates that the oil is mobile at room temperature, which we believe improves the economics of this oil field. Upon shutting down operations on the Indian #1-15 well, the produced oil was moved to our production facilities at Yowlumne. In September of 2014, we discovered that oil had been stolen from our Yowlumne production facilities, and subsequently contacted the police and filed a police report. To date, this matter has not been resolved.

[\(table of contents\)](#)**CITADEL EXPLORATION, INC.****Notes to CONSOLIDATED Financial Statements****(AUDITED)****NOTE 4 – OIL AND GAS PROPERTIES (CONTINUED)**

We received notice on or about July 10, 2013 that the Center for Biological Diversity (“CBD”) had filed a law suit against the County of San Benito regarding the approval of Project Indian which is described more full, above, as the “Case”. The Board of Supervisors voted 5-0 in favor of our application to drill 15 exploration wells on our Project Indian lease. The Court approved the petition in a judgment entered on September 4, 2014, and ruled that Citadel was required to obtain an environmental impact report before commencing Project Indian. Thereafter, the Court awarded the petitioner \$347,969 as attorney’s fees and costs against the County of San Benito and Citadel, jointly and severally. The Company is in the process of appealing this award. At this time management is unable to estimate the minimum liability that may be incurred if any as a result of the outcome of this appeal and therefore has made no provision in the financial statements for liability related to this case.

On September 1, 2014 the Company was granted a three year lease extension at Project Indian.

Per ASC 932, these wells qualify as exploratory wells and review of the capitalized costs incurred to prove up reserves must to be evaluated in the period of one year after the completion of the drilling date.

The following table reflects the net changes in capitalized exploratory well costs that have been capitalized for a period of one year or less since completion of drilling during as of December 31, 2014:

	2014
Beginning balance at January 1	\$1,373,363
Additions to capitalized exploratory well costs pending the determination of proved reserves	717,441
Asset retirement obligation	48,750
Reclassifications to wells, facilities and equipment based on the determination of proved reserves	—
Capitalized exploratory well costs charged to expense	—
Ending balance at December 31	\$2,042,054

Yowlumne

In May 2013, the Company entered into a one year lease for approximately 2,800 acres from AERA Energy, LLC. This acreage has been mapped using a combination of both 2D and 3D seismic, and is

In May 2013, the Company entered into a one year lease for approximately 2,800 acres from AERA Energy, LLC. This acreage has been mapped using a combination of both 2D and 3D seismic, and is in close proximity to the Yowlumne oil field in Kern County, California. The Company is obligated to pay royalties to AERA Energy, LLC on oil and gas from all wells on the leased premises, and the royalty is a total of 20% of the market value. In August of 2013, the Company entered into an agreement to sell 55% of the interest in the Yowlumne lease, recouping approximately 85% of its cost, while retaining a 25% interest in the lease and operatorship. Additionally, as part of this transaction, the Company retained 100% interest in the Yowlumne #2-26 well, which was originally drilled in 2007. After performing a workover job on this well, it has produced approximately 120 barrels of oil which were sold in December 2013. As of year end 2013, the well had produced approximately 50 barrels of oil which were stored in a tank and valued at net realizable value on the balance sheet as product inventory.

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CITADEL EXPLORATION, INC.

Notes to CONSOLIDATED Financial Statements

(AUDITED)

NOTE 4 – OIL AND GAS PROPERTIES (CONTINUED)

On July 11, 2014, the Company announced that it had ended its joint venture with Sojitz Energy Ventures. In connection with the termination of the joint venture the Company entered into an agreement with Sojitz to exchange working interests in various properties. Under the agreement the Company agreed to transfer its ownership interest in the Tejon project in exchange for Sojitz's working interest in the Indian and Yowlumne projects. After the transfer the Company owns 100% of the working interest in project Indian and 80% of the working interest at Yowlumne. In addition to the transfer of working interests in the properties the Company and Sojitz agreed to settle certain amounts recorded as a receivable from Sojitz and a payable to Sojitz in the amounts of \$22,507 and \$97,451, respectively. In connection with this transaction the Company incurred legal cost and fees related to land leases totaling \$41,687. As a result of the above exchange of assets, the Company recorded a net reduction of oil and gas properties in the amount of \$33,297. This exchange of assets was accounted for as a nonmonetary exchange of assets in accordance with ASC 845.

In December of 2014, the Company entered into an agreement with Cibolo Creek Partners and Jim Walesa to invest \$300,000 dedicated to the workover of the Yowlumne #2-26 well. In this agreement, Cibolo and Walesa will receive 75% of the net revenue interest from the well until the \$300,000 is fully repaid. At that time Cibolo and Walesa will receive a 3% overriding royalty on the well. Mr. Walesa is a member of Cibolo Creek Partners and also a member of the Citadel Exploration Board of Directors. We have classified the \$300,000 due as a long-term liability, however the liability is only tied to the production from the Yowlumne #2-26 well, and if the well does not produce in sufficient quantities for the investors to recoup their investment, Citadel has no further liability.

During 2014, we did not renew the leases on our Shiloh prospect due to lower than anticipated natural gas prices, and capital being allocated to our oil properties.

NOTE 5 – FIXED ASSETS

Fixed assets as of December 31, 2014 and 2013 are as follows:

2014	2013
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Vehicle	\$33,572	\$23,572
Website	1,375	1,375
Furniture	10,000	—
Computer Equipment	8,165	—
Less: Accumulated depreciation	(27,185)	(12,314)
	\$25,927	\$12,633

Depreciation expense for the years ended December 31, 2014 and 2013 was \$14,869 and \$8,315.

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[\(table of contents\)](#)**CITADEL EXPLORATION, INC.****Notes to CONSOLIDATED Financial Statements****(AUDITED)****NOTE 6 – NOTES PAYABLE**

Notes payable consists of the following at:

	December 31, 2014	December 31, 2013
Two notes payable to investors, unsecured, 10% interest; due October 30, 2014	500,000	—
Three notes payable to individuals, 10% interest, due January 1, 2014	—	300,000
Three note payables to an entity for the financing of insurance premiums, unsecured; 8.63% interest, due April 2015; 14% interest, due February 2014; 11% interest, due August 2014	7,771	14,134
Promissory note to an entity; 10% interest, due December 2015	100,000	—
Debt discount for 25,000 shares issued relating to note payable	(1,930)	
Debt discount for derivative liability embedded in note payable	(13,308)	
	\$592,533	\$314,134

Interest expense for the year ended December 31, 2014 was \$202,902. Of that amount, \$43,819 is interest expense relating to notes payable and insurance financing, and \$159,083 is amortization of debt discount. Interest expense for the year ended December 31, 2013 was \$216,748. Of that amount \$15,980 is interest expense relating to notes payable and insurance financing, and \$200,768 is amortization of debt discount. The \$500,000 of notes, were due on October 30, 2014 and are currently in default.

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CITADEL EXPLORATION, INC.

Notes to CONSOLIDATED Financial Statements

(AUDITED)

NOTE 6 – NOTES PAYABLE (CONTINUED)

In March 2014, the Company closed on a \$500,000 bridge loan from two individuals. These notes have a 180 day term and bear interest of 10%. Additionally the investors received 500,000 warrants to purchase the Company's stock at \$1.00 per share for a term of two years. These loans were extended 30 days, now due October 30, 2014, with new terms on the warrants of \$0.34 per share for the same two year term. Due to the change in the terms of the warrants the Company recalculated the value of the warrants and recognized a gain on the extinguishment of \$73,573. Because the terms are substantially different, the change in terms has been accounted for as a debt extinguishment under ASC 470.

NOTE 7 – PRODUCTION PAYMENT LIABILITY

In December 2014, the company entered into a financing agreement with two entities. The company received \$300,000 in total from both entities to fund costs of the Yowlumne 2-26 well recompletion. In return for the funds received, the two entities will receive a combined 75% of the net revenue from the well until the \$300,000 is repaid. At the time of repayment, the entities will own a total 3% overriding royalty on the well. This liability is completely dependent on the well generating revenue. If the well fails to generate enough revenue to repay the \$300,000, Citadel is not responsible for the unpaid amount. According to ASC 932-470-25 Section B, "Funds advanced to an operator that are repayable in cash out of the proceeds from a specified share of future production of a producing property, until the amount advanced \$300,000 is paid in full, shall be accounted for as a borrowing. The advance is a payable for the recipient of the cash invested. Given the wells current production of approximately 20 barrels per day, coupled with the current oil price of approximately \$50.00 per barrel, we believe it will take more than two years for payback to occur, therefore this has been classified as a long-term payable.

NOTE 8 – ASSET RETIREMENT OBLIGATION

The Company's ARO relates to future costs associated with the plugging and abandonment of oil and natural gas wells, removal of equipment facilities from leased acreage and land restoration in accordance with applicable local, state and federal laws. The discounted fair value of an ARO liability is required to be recognized in the period in which it is incurred, with the associated asset retirement cost capitalized as part of the carrying cost of the oil and natural gas asset. In periods subsequent to the initial measurement of the ARO, the Company must recognize period-to-period changes in the liability resulting from the passage of time and revisions to either the timing or the

amount of the original estimate of undiscounted cash flows. Increases in the ARO liability due to the passage of time impact net earnings as accretion expense. The related capital cost, including revisions thereto, is charged to expense through depreciation, depletion and amortization of oil and natural gas production over the life of the oil and natural gas field.

In October 2013, the Company announced its first oil production on the Yowlumne 2-26 well and therefore an asset retirement obligation was recorded on this well as follows.

	2014
Beginning asset retirement obligation	\$31,407
Liabilities acquired from property acquisition	17,517
Accretion expense	—
Ending asset retirement obligation	\$48,923

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CITADEL EXPLORATION, INC.

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. As of December 31, 2014 and 2013, 31,389,000 and 28,949,823 shares, respectively, were issued and outstanding.

In February 2013, the Company issued 912,640 shares of restricted common stock for the conversion of loans and interest in the amount of \$310,298. The fair value of the shares at the date of settlement was \$332,798, which resulted in the Company recording \$22,500 in additional interest expense.

In February 2013, the Company issued 320,000 shares of restricted common stock valued at \$116,000 to various parties for accounting, legal and marketing services.

In September 2013, the Company closed on a \$200,000 bridge loan from two individuals. In October 2013, the Company closed an additional \$100,000 bridge loan from one investor. These notes have a 90 day term and bear interest of 10%. Additionally, each investor received 100,000 warrants to purchase the Company's stock at \$1.00 per share for a term of one year valued at \$93,750 in total.

During the year ended December 31, 2013, the Company issued 5,104,183 shares of restricted common stock for cash consideration of \$1,918,956, less issuance cost of \$12,531.

During the year ended December 31, 2013, the Company recognized \$149,994 in stock option compensation in accordance with employment agreements with the company's two executive directors.

In January 2014, the Company issued 205,085 shares of common stock for services rendered and prepaid expenses with a value of \$114,338.

In January 2014, the Company issued 559,092 shares of common stock to settle three notes payable and accrued interest totaling \$306,849. The shares were recorded at fair value of \$273,304, resulting in a gain of \$33,545.

In March of 2014, the Company closed on a \$500,000 bridge loan from two individuals. These notes have a 180 day term and bear interest of 10%. Additionally investors received 500,000 warrants to purchase the Company's stock at \$1.00 per share for a term of two years, valued at \$147,102 in total. In September of 2014, the maturity date of this bridge loan was extended by 30 days, in return the exercise price of the warrant was reduced to \$0.34 per share, with the original two year term remaining. Due to the change in the terms of the warrants, the Company recalculated the value of the warrants to be \$85,325. Accordingly, the Company recognized a gain on the extinguishment of \$73,573.

In July of 2014, investors owning warrants for the company's stock, converted early at a reduced price. The first tranche of warrants equaled 500,000 shares at \$0.55, which were reduced to \$0.34 resulting in the issuance of 500,000 common stock shares for \$170,000 or \$0.34 per share. The second tranche of warrants equaled 100,000 warrants at \$1.00 per share. These warrants were exchanged for the issuance of 300,000 shares at \$0.34 for \$102,000 in cash.

At December 2014, the company was obligated to issue 25,000 shares of common stock in connection with a note payable. On the date the agreement was executed, the price per share of the Company's stock was \$0.09. As the shares have not been issued as of December 31, 2014, the Company recorded a stock payable with at value of \$2,250.

During the year ended December 31, 2014, the Company issued 875,000 shares of common stock valued at \$183,500 to various parties for accounting, legal, and marketing services.

[\(table of contents\)](#)**CITADEL EXPLORATION, INC.****Notes to CONSOLIDATED Financial Statements****(AUDITED)****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 the years ended December 31, 2014 and 2013, \$149,995 and \$113,888, respectively, was recorded as a stock based compensation expense.

On June 18, 2014 as approved by the Board of Directors, the Company granted 800,000 stock options to four members of the Board of Directors, which vested immediately, at \$0.55 for terms of seven years. The total fair value of these options at the date of grant was estimated to be \$264,495 and was determined using the Black-Scholes option pricing model with an expected life of 7 years, a risk free interest rate of 0.45%, dividend yield of 0%, and expected volatility of 235%. During the year ended December 31, 2014, \$264,494 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, 2014 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, 2014	4,000,000	\$ 0.20	4.68
Granted	800,000	\$ 0.55	6.42
Exercised	—	\$ 0.00	—

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Cancelled	—	\$ 0.00	—
Outstanding at December 31, 2014	4,800,000	\$ 0.26	5.65
Exercisable at December 31, 2014	3,200,000	\$ 0.22	3.79

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CITADEL EXPLORATION, INC.

Notes to CONSOLIDATED Financial Statements

(AUDITED)

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 as amortization of debt discount and included in interest expense. During year ended December 31, 2013, \$178,267 was recorded amortization of debt discount and included in interest expense.

In September 2013, we closed on a \$200,000 90-day bridge loan with two investors. The loans bear interest of 10%. Additionally each investor was granted 100,000 stock warrants to purchase stock at \$1.00 per share for a period of one year. The total fair value of these warrants at the date of grant was estimated to be \$56,283 and was determined using the Black-Scholes option pricing model with an expected life of 2 years, a risk free interest rate of 0.1%, a dividend yield of 0% and expected volatility of 197%. An additional \$100,000 note payable with the same terms and warrants which were issued in October 2013 . The total fair value of these warrants at the date of grant was estimated to be \$37,467 and was determined using the Black-Scholes option pricing model with an expected life of 2 years, a risk free interest rate of 0.1%, a dividend yield of 0% and expected volatility of 197%. During the year ended December 31, 2013, \$21,297 was recorded as amortization of debt discount and included in interest expense. During the year ended December 31, 2014, \$63,892 was recorded as amortization of debt discount and included in interest expense.

In March 2014, the Company closed on a \$500,000 180-day bridge loan with two investors. The loans bear interest of 10%. Additionally, the investors were granted a total of 500,000 stock warrants to purchase stock at \$1.00 per share for a period of two years valued at \$147,102. The total fair value of these warrant at the date of grant was determined using the Black-Scholes option pricing model with an expected life of 2 years, a risk free interest rate of 0.45%, a dividend yield of 0% and expected volatility of 333%. In September of 2014, the maturity date of this bridge loan was extended by 30 days, in return the exercise price of the warrant was reduced to \$0.34 per share, with the original two year term remaining. Due to the change in the terms of the warrants, the Company recalculated the value of the warrants to be \$85,325. Accordingly, the Company recognized a gain on the extinguishment of \$73,573.

In September of 2014, the 500,000 warrants issued on November 15, 2012 and 100,000 warrants issued in September 2013 were exercised early at a reduced price of \$0.34 per share.

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The following is a summary of the status of all of the Company's stock warrants as of December 31, 2014 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, 2014	800,000	\$ 0.72	0.89
Granted	500,000	\$ 0.34	1.33
Exercised	600,000	\$ 0.34	—
Cancelled	—	\$ 0.00	—
Outstanding at December 31, 2014	500,000	\$ 0.34	1.33
Exercisable at December 31, 2014	500,000	\$ 0.34	1.33

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CITADEL EXPLORATION, INC.

Notes to CONSOLIDATED Financial Statements

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NOTE 12 – RELATED PARTY TRANSACTIONS

On September 15, 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 it 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, 2013 and 2012, the Company recorded executive compensation totaling \$216,302 and \$114,997, respectively.

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, 2014 and 2013, the Company recording executive compensation totaling \$256,944 and \$214,997, respectively.

As of the second year of the employment agreement from September 2013 to September 2014, the CEO and CFO have deferred payment of approximately \$5,000 per month of salary. As of the third year of the employment from September 2014 to present, the CEO and CFO have deferred payment of approximately \$10,000 per month of salary.

As of December 31, 2014 and 2013, \$203,042 and \$55,000 is included in accounts payable and accrued liabilities related to the employment agreements with the CEO and CFO.

During the year ended December 31, 2014, the Company made the following purchases from KVOS, an oil field service company owned by Jams Borgna a member of Citadel Exploration's Board of Directors; \$39,199.43 of oil field equipment and services.

During the year ended December 31, 2014, the Company purchased a vehicle from an officer's wife for \$10,000. As of the date of this report the full amount was still owed and booked as an accounts payable.

In December 2014, we entered into an agreement with Jim Walesa and Cibolo Creek Partners to fund \$300,000 towards the Yowlumne #2-26 recompletion. In this agreement Mr. Walesa and Cibolo Creek will receive 75% of the net revenue after expenses, until they have received \$300,000 in payment. Upon full repayment, Mr. Walesa and Cibolo Creek will receive a 3% royalty on the well. Mr. Walesa is currently on the Board of Directors of Citadel and a member of Cibolo Creek Partners.

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CITADEL EXPLORATION, INC.

Notes to CONSOLIDATED Financial Statements

(AUDITED)

NOTE 13 – SUBSEQUENT EVENTS

In February of 2015, the Company announced that recompletion efforts at the Yowlumne #2-26 were successful and that the well is currently producing approximately 25 barrels per day.

In March of 2015, the Company approved the issuance of 1,400,000 common stock shares for the conversion of a \$100,000 promissory note, plus accrued interest of \$2,164 and an additional capital investment of \$107,835, all at \$0.15 per share.

In March of 2015, the Company entered into a non-binding letter of intent (LOI) with Cibolo Creek Partners, a private equity firm based in Midland, Texas for funding of certain oil and natural gas acquisitions in the State of California.

In March of 2015, the Company issued 25,000 shares of common stock to settle the stock payable of \$2,250 recorded as of December 31, 2014.

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