

Citadel Exploration, Inc.
Form 10-Q
May 17, 2012

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

FORM 10-Q

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

For the quarterly period ended March 31, 2012

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

Commission file number 000-54639
[Missing Graphic Reference]
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.)

420 Bryant Circle, Unit D
Ojai, California 93023
(Address of principal executive offices)

(530) 871-1484
(Registrant's telephone number, including area code)

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Indicate by check mark whether the issuer (1) 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 Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

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(§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 whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The number of shares of Common Stock, \$0.001 par value, outstanding on May 7, 2012 was 20,362,500 shares.

CITADEL EXPLORATION, INC.
QUARTERLY PERIOD ENDED MARCH 31, 2012

Index to Report on Form 10-Q

	Page No.
PART I - FINANCIAL INFORMATION	
Item 1. Financial Statements	3
Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations	12
Item 3. Quantitative and Qualitative Disclosures About Market Risk	18
Item 4T. Controls and Procedures	18
PART II - OTHER INFORMATION	
Item 1. Legal Proceedings	19
Item 1A. Risk Factors	19
Item 2. Unregistered Sales of Equity Securities and Use of Proceeds	19
Item 3. Defaults Upon Senior Securities	19
Item 5. Other Information	19
Item 6. Exhibits	20
Signature	21

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements.

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

	March 31, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash	\$ 106,320	\$ 1,245
Prepaid expenses	300	16,664
Prepaid stock compensation	40,000	60,000
Total current assets	146,620	77,909
Oil and gas properties	144,215	205,360
Website, net	993	1,108
Total assets	\$ 291,828	\$ 284,377
LIABILITIES AND STOCKHOLDERS' EQUITY (DEFICIT)		
Current liabilities:		
Overdraft in trust account	\$ 286	\$ 286
Accounts payable	29,746	107,709
Accounts payable - related party	10,488	-
Accrued interest payable	3,270	1,907
Accrued interest payable - related party	3,649	2,504
Note payable	55,298	55,298
Notes payable - related party	62,690	131,650
Total current liabilities	165,427	299,354
Total liabilities	165,427	299,354
Stockholders' equity (deficit):		
Common stock, \$0.001 par value, 100,000,000 shares authorized, 20,320,000 and 20,320,000 shares issued and outstanding as of March 31, 2012 and December 31, 2011, respectively	20,320	20,320
Additional paid-in capital	161,938	160,958
Stock payable	34,000	34,000
Deficit accumulated during exploration stage	(89,857)	(230,255)

Total stockholders' equity (deficit)	126,401	(14,977)
Total liabilities and stockholders' equity (deficit)	\$291,828	\$284,377

See Accompanying Notes to Consolidated Financial Statements.

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

	For the three months ended March 31,		Inception (November 6, 2006) To March 31, 2012
	2012	2011 (restated)	
Revenue	\$-	\$-	\$-
Operating expenses:			
General and administrative	17,716	1,393	82,174
General and administrative - related party	31,465	-	31,465
Amortization	115	-	382
Professional fees	46,313	-	199,621
Professional fees - related party	30,000	-	30,000
Gain on sale of interest in oil & gas properties	(267,856)	-	(267,856)
Gain on settlement of accounts payable	(661)	-	(661)
Total operating (income) expenses	(142,908)	1,393	75,125
Other expense:			
Interest expense	(1,364)	-	(5,253)
Interest expense - related party	(1,146)	-	(3,650)
Total other expenses	(2,510)	-	(8,903)
Net income (loss) before provision for income taxes	140,398	(1,393)	(84,028)
Provision for income taxes	-	-	(5,829)
Net income (loss)	\$ 140,398	\$(1,393)	\$(89,857)
Weighted average number of common shares outstanding - basic	20,320,000	14,000,000	
Net loss per share - basic	\$0.01	\$(0.00)	

See Accompanying Notes to Consolidated Financial Statements.

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

	For the three months ended March 31,		Inception (November 6, 2006) to March 31, 2012
	2012	2011	
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	\$ 140,398	\$(1,393)	\$(89,857)
Adjustments to reconcile net income (loss) to net cash (used in) operating activities:			
Amortization	115	-	382
Amortization of prepaid stock compensation	20,000	-	40,000
Gain on sale of interest in oil & gas properties	(267,856)	-	(267,856)
Gain on settlement of accounts payable	(661)	-	(661)
Changes in operating assets and liabilities:			
(Increase) decrease in prepaid expenses	8,503	-	(300)
Increase (decrease) in accounts payable	(69,441)	-	1,142
Increase in accounts payable - related party	10,488	-	10,488
Increase in accrued interest payable	1,363	-	3,270
Increase in accrued interest payable - related party	1,145	-	3,649
Net cash used in operating activities	(155,946)	(1,393)	(299,743)
CASH FLOWS FROM INVESTING ACTIVITIES			
Purchase of oil and gas properties	(20,999)	(25,661)	(226,359)
Proceeds from sale of interest in oil & gas properties	350,000	-	350,000
Website	-	-	(1,375)
Net cash provided by (used in) investing activities	329,001	(25,661)	122,266
CASH FLOWS FROM FINANCING ACTIVITIES			
Increase in overdraft from trust account	-	-	286
Member contributions	980	27,761	105,523
Member distribution	-	-	10,000
Proceeds from sale of common stock, net of offering costs	-	-	50,000
Proceeds from notes payable	-	-	55,498
Proceeds from notes payable - related party	26,040	-	157,490
Repayments for notes payable - related party	(95,000)	-	(95,000)
Net cash provided by (used in) financing activities	(67,980)	27,761	283,797
NET CHANGE IN CASH	105,075	707	106,320
CASH AT BEGINNING OF YEAR	1,245	-	-

CASH AT END OF PERIOD	\$ 106,320	\$ 707	\$ 106,320
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SUPPLEMENTAL INFORMATION:

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

NON CASH INVESTING AND FINANCING ACTIVITIES:

Liabilities assumed with the acquisition of Citadel Exploration, LLC	\$-	\$-	\$29,265
Shares issued for prepaid stock compensation	\$-	\$-	\$80,000

See Accompanying Notes to Consolidated Financial Statements.

Citadel Exploration, Inc.
(An Exploration Stage Company)
Notes to Consolidated Financial Statements

NOTE 1 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation

The interim financial statements included herein, presented in accordance with United States generally accepted accounting principles and stated in US dollars, have been prepared by the Company, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading.

These statements reflect all adjustments, consisting of normal recurring adjustments, which in the opinion of management, are necessary for fair presentation of the information contained therein. It is suggested that these interim financial statements be read in conjunction with the financial statements of the Company for the year ended December 31, 2011 and notes thereto included in the Company's 10-K annual report and all amendments. The Company follows the same accounting policies in the preparation of interim reports.

Results of operations for the interim period are not indicative of annual results.

Principles of Consolidation

For the three months ended March 31, 2011, the consolidated financial statements include the accounts of Citadel Exploration, LLC. For the three months ended March 31, 2012, 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.

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 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.

Citadel Exploration, Inc.
(An Exploration Stage Company)
Notes to Consolidated Financial Statements

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 year. Diluted earnings per common share calculations are determined by dividing net income by the weighted average number of common shares and dilutive common share equivalents outstanding. During periods when common stock equivalents, if any, are anti-dilutive they are not considered in the computation.

Oil and gas properties

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

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

Citadel Exploration, Inc.
(An Exploration Stage Company)
Notes to Consolidated Financial Statements

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

Revenue recognition

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

Reclassification

Certain reclassifications have been made to prior years' financial statements to conform to the current year presentation. These reclassifications had no effect on previously reported results of operations or accumulated deficit during exploration stage. The Company reclassified \$200 notes payable to notes payable – related party.

Recent pronouncements

The Company has evaluated the recent accounting pronouncements through April 2012 and believes that none of them will have a material effect on the Company's financial statements.

NOTE 2 – GOING CONCERN

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern, which contemplates the recoverability of assets and the satisfaction of liabilities in the normal course of business. As noted above, the Company is in the development stage and, accordingly, has not yet generated revenues from operations. Since its inception, the Company has been engaged substantially in financing activities and developing its business plan and incurring start up costs and expenses. As a result, the Company incurred accumulated net losses from Inception (November 6, 2006) through the period ended March 31, 2012 of \$89,857. In addition, the Company's development activities since inception have been financially sustained through debt and equity financing.

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

Citadel Exploration, Inc.
 (An Exploration Stage Company)
 Notes to Consolidated Financial Statements

NOTE 3 – PREPAID EXPENSES

As of December 31, 2011, the Company had prepaid insurance totaling \$16,664. The prepaid insurance will be expensed on a straight line basis over the life of the insurance policy. During the quarter ended March 31, 2012, the Company cancelled the insurance policy and adjusted the remaining balance due of \$7,861 to the finance company and reduced prepaid insurance by \$7,861. The Company does not expect to receive any refunds from the finance company or from the insurance company as a result of the early cancellation of the insurance policy. The insurance expense for the three months ended March 31, 2012 was \$8,803.

During the three months ended March 31, 2012, the Company prepaid consulting costs totaling \$300. As of March 31, 2012, the balance of prepaid consulting was \$300. The prepaid consulting was expensed during April 2012 when the services were rendered.

NOTE 4 – OIL AND GAS PROPERTIES

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

	2012	2011
Oil and gas property lease	\$86,385	\$61,984
Exploration	57,830	143,376
	\$144,215	\$205,360

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

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

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

Citadel Exploration, Inc.
 (An Exploration Stage Company)
 Notes to Consolidated Financial Statements

NOTE 5 – NOTE PAYABLE

Note payable consists of the following at:

	March 31, 2012	December 31, 2011
Note payable to an individual, line of credit to borrow up to \$100,000, unsecured, 10% interest, due upon demand	\$55,298	\$55,298
	\$55,288	55,298

Interest expense for the three months ended March 31, 2012 and 2011 was \$1,364 and \$0, respectively.

NOTE 6 – NOTES PAYABLE – RELATED PARTY

Notes payable consist of the following at:

	March 31, 2012	December 31, 2011
Note payable to an entity owned and controlled by an officer, director and shareholder, line of credit to borrow up to \$100,000, unsecured, 4% interest, due upon demand	\$33,240	\$87,200
Note payable to an entity owned and controlled by an officer, director and shareholder, line of credit to borrow up to \$50,000, unsecured, 4% interest, due upon demand	13,450	28,450
Note payable to an entity owned and controlled by an officer, director and shareholder, line of credit to borrow up to \$50,000, unsecured, 4% interest, due upon demand	13,250	13,250
Note payable to a director, unsecured, due upon demand, 0% interest	2,750	2,750
	\$62,690	\$131,650

Interest expense for the three months ended March 31, 2012 and 2011 was \$1,146 and \$0, respectively.

NOTE 7 – STOCKHOLDERS' EQUITY

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

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

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

During the three months ended March 31, 2012, an officer, director and shareholder donated capital of \$980.

During the three months ended March 31, 2012, there have been no other issuances of common stock.

Citadel Exploration, Inc.
(An Exploration Stage Company)
Notes to Consolidated Financial Statements

NOTE 8 – WARRANTS AND OPTIONS

As of March 31, 2012, there were no warrants or options outstanding to acquire any additional shares of common stock.

NOTE 9 – RELATED PARTY TRANSACTIONS

On January 1, 2012, the Company entered into a consulting and rental agreement with an entity owned and controlled by an officer, director and shareholder. The consulting fees are fixed at \$10,000 per month and the rent is up to \$25,000 per month. The agreement automatically expires on July 1, 2013 unless the parties mutually agree to extend the term. The Company will have a one-time option to extend the term of the agreement by compensating the related party with a renewal bonus of \$500,000 at which time the agreement would continue for an additional 18 months at the same terms and conditions of the agreement. During the three months ended March 31, 2012, the Company recorded consulting fees of \$30,000 and rent expense of \$31,465.

During March 2012, the Company repaid a total of \$95,000 to reduce balances in the lines of credit due to entities owned and controlled by an officer, director and shareholder.

NOTE 10 – SUBSEQUENT EVENTS

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

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

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

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

as well as other statements regarding our future operations, financial condition and prospects, and business strategies. These forward-looking statements are subject to certain risks and uncertainties that 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 Quarterly Report on Form 10-Q, and in particular, the risks discussed under the heading "Risk Factors" in Part II, Item 1A and those discussed in other documents we file with the Securities and Exchange Commission. We undertake no obligation to revise or publicly release the results of any revision to these forward-looking statements. Given these risks and uncertainties, readers are cautioned not to place undue reliance on such forward-looking statements.

References in the following discussion and throughout this quarterly report to "we", "our", "us", "Citadel", "the Company", and similar terms refer to Citadel Exploration, Inc. and its subsidiaries, unless otherwise expressly stated or the context otherwise requires.

Overview

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

Our revenues, profitability and future growth depend substantially on prevailing prices for oil and natural gas and our ability to find, develop and acquire oil and gas reserves that are economically recoverable.

Our Projects

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

Citadel has accepted a written invitation to participate with Blackhawk Exploration LLC (Blackhawk) and Sojitz Energy Ventures (Sojitz) in the redevelopment of Pastoria Creek Oilfield. Subject to the consolidation of interest on the 160 acre lease (Pastoria Creek A block) and adequate financing, Citadel will participate in a vertical well and a horizontal development well in the near term. Citadel will also participate in a vertical test well on the adjacent, recently acquired 600 acre block (Pastoria Creek B block) subject to adequate financing.

Citadel has accepted a written invitation to participate with The Nahabedian Exploration Group LLC (NEG) and Sojitz Energy Ventures (Sojitz) in the development and extension of Landslide Oilfield. Subject to the consent of the fee mineral interest owner, permit availability, and adequate financing, Citadel will participate in a directional development well in the near term.

On January 31, 2009, our wholly-owned subsidiary, CEL, entered into an Oil and Gas Lease (“Lease”) for 688.71 acres of property with Vintage Petroleum, LLC (“Vintage”), a company owned by Occidental Petroleum (NYSE:OXY), for an initial term of three years. During February 2012, we entered into a new lease with Vintage for a period of two years.

Other Events

In September 2011, Citadel entered into a non-binding letter agreement with Nahabedian Exploration Group LLC (NEG), wherein Citadel agreed to retain NEG as geologic consultants for activities planned in the next 18 to 36 months. In addition, pursuant to the letter and subject to provisions of adequate funding of Citadel, NEG proposed that Citadel shall pay NEG the retainer of \$10,000 per month for a primary term of 18 months. During the primary term, Citadel will have a first right to review and participate in oil and gas drilling prospects which are developed by the NEG staff. Both NEG and Citadel have agreed in principal that Citadel will have the right to participate with NEG by paying 1/3 of the costs of an initial well to earn 25% of the interest. Citadel may elect to increase its interest in a test well under the same terms (1/3 FOR 1/4) for up to 50% of the interest in the well and prospect area. NEG will also earn a 1% royalty on every prospect generated. A modified version of a California 610 operating agreement is being drafted by NEG to reflect that agreement. At the end of the primary term, Citadel shall have a one-time option to extend the primary term by paying NEG a renewal bonus of \$500,000, at which point the consulting agreement will be extended for an additional 18 months under the same general terms and conditions.

On February 22, 2012, we executed a “Letter Agreement Sale of Partial Interest in Vintage Lease, Project Indian” (“Vintage Lease Agreement”) with Sojitz Energy Venture, Inc. (“Sojitz”), whereby we sold to Sojitz an undivided Forty percent (40%) interest (“Assigned Interest”) relating to the Oil, Gas, and Mineral Lease dated February 1, 2012 from Vintage Petroleum California, LLC (the “Lessor”), a Delaware Limited Liability Company and wholly owned subsidiary of Occidental Petroleum, to Citadel, as Lessee. The Vintage Lease Agreement relates to a property known as “Project Indian,” which is located in San Benito County, California, covering approximately 688.71 acres of land, for a term of Five (5) years. As consideration for the Assigned Interest, Sojitz paid Citadel the sum of Three Hundred and Fifty Thousand Dollars (\$350,000). Additionally, as part of the Vintage Lease Agreement, the parties entered into a Joint Operating Agreement (“JOA”), which includes all area under the Lease, as well as an area designated as Area of Mutual Interest or “AMI”. During the quarter ended March 31, 2012, the Company recorded a gain of the sale of the partial interest totaling \$267,856.

Going Concern

The financial statements included in this filing have been prepared in conformity with generally accepted accounting principles that contemplate the continuance of the Company as a going concern, which contemplates the realization of assets and liquidation of liabilities in the normal course of business. However, the Company is in the development stage and, accordingly, has not generated revenues from operations. As shown on the accompanying financial statements, the Company has incurred a net loss of \$89,857 for the period from inception (November 6, 2006) to March 31, 2012. These conditions raise substantial doubt about the Company’s ability to continue as a going concern.

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

RESULTS OF OPERATIONS

During the three month period ended March 31, 2012 and 2011, we did not generate revenue.

Operating expenses, net of gains on the sale of interest in oil & gas properties and the gain on the settlement of accounts payable, totaled income of \$142,908 during the three month period ended March 31, 2012 as compared to total expense of \$1,393 in the prior three month period ended March 31, 2011. Operating expenses primarily consisted of general and administrative fees, general and administrative – related party, professional fees, professional fees-related party, and amortization in the three month period ended March 31, 2012.

General and administrative fees increased \$16,323 from the three month period ended March 31, 2011 to the three month period ended March 31, 2012. This increase was primarily as a result of the insurance policy for the Company and increases for automobile expenses, phone expenses and travel expenses.

General and administrative –related party fees increased \$31,465 from the three month period ended March 31, 2011 to the three month period ended March 31, 2012. This increase was primarily as a result of the placement of the Company in a corporate office.

Professional fees increased \$46,313 from the three month period ended March 31, 2011 to the three month period ended March 31, 2012. The increase was primarily due to an increase in legal fees.

Professional fees – related party increased \$30,000 from the three month period ended March 31, 2011 to the three month period ended March 31, 2012. The increase was due to the monthly consulting fees at \$10,000 per month which was effective on January 1, 2012. The consultants were engaged due to increased activity by the Company and the initiation of a prospect generation and evaluation program.

Gain on the sale of interest in oil & gas properties increased \$267,856 during the three months ended March 31, 2012 as compared to the three month period ended March 31, 2011. The increase was due to the sale of 40% of the interest in the Indian project.

Gain on the settlement of accounts payable increased \$661 during the three months ended March 31, 2012 as compared to the three month period ended March 31, 2011. The increase was due to the settlement of accounts payable to one vendor.

Amortization fees increased \$115 from the three month period ended March 31, 2011 to the three month period ended March 31, 2012. The increase was primarily due to amortization on the website.

Liquidity and Capital Resources

As of March 31, 2012, we had \$106,320 in cash, \$300 in prepaid expenses, and \$40,000 in prepaid stock compensation. The following table provides detailed information about our net cash flow for all financial statement periods presented in this Quarterly Report. To date, we have financed our operations through the issuance of stock and borrowings from related parties and an unrelated third party.

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

	Three Months Ended March 31,	
	2012	2011
Net cash used in operating activities	\$(155,946)	\$(1,393)
Net cash provided by (used in) investing activities	329,001	(25,661)
Net cash provided by (used in) financing activities	(67,980)	27,761
Net increase in Cash	105,075	707
Cash, beginning of year	1,245	-
Cash, end of year	\$ 106,320	\$ 707

Operating activities

Net cash used in operating activities was \$155,946 for the three month period ended March 31, 2012. The net cash used in operating activities consisted primarily of professional fees. Additionally, the most significant change was due to the gain on sale of interest in oil & gas properties.

Investing activities

Net cash provided by investing activities was \$329,001 for the three month period ended March 31, 2012. The net cash provided by investing activities consisted of payments for the lease payment on oil and gas property of \$20,640. Additionally, the most significant change was due to the proceeds received totaling \$350,000 on sale of interest in oil & gas properties.

Financing activities

Net cash used in financing activities for the three month period ended March 31, 2012 was \$67,980. The net cash provided by financing activities was mainly attributable to proceeds of \$26,040 from notes payable – related party. The net cash used in financing activities was mainly attributable to repayment of \$95,000 on notes payable – related party.

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

Without cash flow from operations we will require additional cash resources, including the sale of equity or debt securities, to meet our planned capital expenditures and working capital requirements for the next 12 months. We will require additional cash resources due to changed business conditions, implementation of our strategy to successfully develop our Shallow Indian Oil Development Project, or acquisitions we may decide to pursue. If our own financial resources and then current cash-flows from operations are insufficient to satisfy our capital requirements, we may seek to sell additional equity or debt securities or obtain additional credit facilities. The sale of additional equity securities will result in dilution to our stockholders. The incurrence of indebtedness will result in increased debt service obligations and could require us to agree to operating and financial covenants that could restrict our operations or modify our plans to grow the business. Financing may not be available in amounts or on terms acceptable to us, if at all. Any failure by us to raise additional funds on terms favorable to us, or at all, will limit our ability to expand our business operations and could harm our overall business prospects.

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

Off-Balance Sheet Arrangements

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

Operation Plan

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

We expect to achieve these results by:

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

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

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

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

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Item 3. Quantitative and Qualitative Disclosure About Market Risk

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

Item 4T. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Our Chief Executive Officer, Armen Nahabedian, and our Principal Financial Officer, Christopher Whitcomb evaluated the effectiveness of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Exchange Act) as of the end of the period covered by this Report. Based on that evaluation and assessment, Mr. Armen Nahabedian and Mr. Christopher Whitcomb 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 and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

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 are reasonably likely to materially affect, our internal control over financial reporting.

Limitations on Effectiveness of Controls and Procedures

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs.

PART II—OTHER INFORMATION

Item 1. Legal Proceedings.

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

Item 1A. Risk Factors

Our significant business risks are described in Item 1A. to Part I of Form 10-K for the year ended December 31, 2011 (filed April 16, 2012) to which reference is made herein.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.

During the three months ended March 31, 2012, we did not have any sales of unregistered securities.

Subsequent Issuance

On May 7, 2012, we issued 42,500 shares of our restricted common stock to 1 accredited investor who purchased the shares in May 2011 for a total purchase price of \$34,000 all of which was paid in cash.

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

Issuer Purchases of Equity Securities

We did not repurchase any of our equity securities from the time of our inception on November 6, 2006 through the period ended March 31, 2012.

Item 3. Defaults Upon Senior Securities.

None.

Item 4. Other Information.

None.

Item 5. Exhibits.

Exhibit No.	Description
31.1	Certification of Chief Executive Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of Chief Financial Officer pursuant to Exchange Act Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
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
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
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema
101.CAL*	XBRL Taxonomy Extension Calculation Linkbase
101.DEF*	XBRL Taxonomy Extension Definition Linkbase
101.LAB*	XBRL Taxonomy Extension Label Linkbase
101.PRE*	XBRL Taxonomy Extension Presentation Linkbase

*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.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CITADEL EXPLORATION, INC.

Date: May 16, 2012

By:

/S/ Armen Nahabedian

Armen Nahabedian

Chief Executive Officer

(Principal Executive Officer and duly authorized signatory)