

**RARE ELEMENT RESOURCES LTD.**  
CONSOLIDATED FINANCIAL STATEMENTS  
For the year ended June 30, 2007  
(AUDITED)

# DE VISSER GRAY

## CHARTERED ACCOUNTANTS

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### AUDITORS' REPORT

To the Shareholders of Rare Element Resources Ltd.

We have audited the consolidated balance sheets of Rare Element Resources Ltd. as at June 30, 2007 and 2006 and the consolidated statements of operations and 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 generally accepted auditing standards in Canada. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2007 and 2006 and the results of its operations and cash flows for each of the years then ended in accordance with Canadian generally accepted accounting principles.

"DeVisser Gray LLP"

**CHARTERED ACCOUNTANTS**

Vancouver, British Columbia  
October 22, 2007

**RARE ELEMENT RESOURCES LTD.  
CONSOLIDATED BALANCE SHEETS**

(Expressed in US Dollars)

**As at June 30**

	<b>2007</b>	<b>2006</b>
<b>ASSETS</b>		
<b>CURRENT</b>		
Cash	\$ 1,085,337	\$ 428,267
Accounts receivable	44,428	24,412
Prepaid expenses	49,651	23,205
	1,179,416	475,884
<b>Equipment</b> (Note 4)	673	-
<b>Investments</b> (Note 5)	15,083	-
<b>Mineral properties and deferred exploration costs</b> (Note 3)	764,147	608,856
<b>Reclamation bond</b> (Note 6)	10,000	10,000
	\$ 1,969,319	\$ 1,094,740
<b>LIABILITIES</b>		
<b>CURRENT</b>		
Accounts payable and accrued liabilities	\$ 16,456	\$ 23,325
Due to related parties (Note 8)	8,257	9,556
	24,713	32,881
<b>SHAREHOLDERS' EQUITY</b>		
<b>SHARE CAPITAL</b> (Note 7)	4,973,386	3,463,293
<b>CONTRIBUTED SURPLUS</b> (Note 7)	240,729	116,579
<b>DEFICIT</b>	(3,269,509)	(2,518,013)
	1,944,606	1,061,859
	\$ 1,969,319	\$ 1,094,740
<b>CONTINUANCE OF OPERATIONS</b> (Note 1)		
<b>SUBSEQUENT EVENTS</b> (Note 12)		

APPROVED BY THE BOARD OF DIRECTORS:

*“Donald E. Ranta”*

Donald E. Ranta

*“Mark T. Brown”*

Mark T. Brown

**RARE ELEMENT RESOURCES LTD.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT**  
*(Expressed in US Dollars)*  
**FOR THE YEAR ENDED JUNE 30**

	<b>2007</b>	<b>2006</b>
<b>EXPENSES</b>		
Audit and legal	\$ 32,025	\$ 28,722
Accounting and administrative fees (Note 8)	87,232	87,294
Amortization	191	-
Bank charges	1,023	715
Foreign-exchange loss (gain)	43,589	11,134
Investor relations and shareholder communication	204,362	155,202
Management fees (Note 8)	74,238	61,923
Office and miscellaneous	37,298	13,119
Rent (Note 8)	7,954	7,740
Stock-based compensation	240,142	52,976
Transfer and listing fees	29,166	19,036
Travel	24,518	20,546
Write-down of mineral properties (Note 3)	4,841	-
	<u>(786,579)</u>	<u>(458,407)</u>
<b>INCOME</b> (Note 5)	<u>35,083</u>	<u>-</u>
<b>NET LOSS FOR THE YEAR</b>	(751,496)	(458,407)
<b>DEFICIT, BEGINNING OF YEAR</b>	<u>(2,518,013)</u>	<u>(2,059,606)</u>
<b>DEFICIT, END OF YEAR</b>	<u>\$ (3,269,509)</u>	<u>\$ (2,518,013)</u>
<b>LOSS PER SHARE</b>	<u>\$ (0.04)</u>	<u>\$ (0.03)</u>
<b>WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING</b>	<u>20,412,956</u>	<u>16,341,819</u>

See accompanying notes to consolidated financial statements

**RARE ELEMENT RESOURCES LTD.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
*(Expressed in US Dollars)*  
**FOR THE YEAR ENDED JUNE 30**

	2007	2006
<b>CASH PROVIDED BY (USED IN) OPERATIONS</b>		
Net loss for the period	\$ (751,496)	\$ (458,407)
Items not involving cash:		
Amortization	191	-
Fair value of warrants received pursuant to the sale of mineral property	(15,083)	-
Stock-based compensation	240,142	52,976
Write-down of mineral properties	4,841	-
	<u>(521,405)</u>	<u>(405,431)</u>
Changes in non-cash working-capital items:		
Accounts receivable	(20,016)	(13,077)
Prepaid expenses	(26,446)	(11,949)
Accounts payable and accrued liabilities	(7,251)	9,253
Due to related parties	(1,299)	4,175
	<u>(576,417)</u>	<u>(417,029)</u>
<b>INVESTING ACTIVITIES</b>		
Deferred exploration costs	(159,750)	(211,641)
Purchase of equipment	(864)	-
	<u>(160,614)</u>	<u>(211,641)</u>
<b>FINANCING ACTIVITIES</b>		
Cash received for common shares	1,394,101	961,013
	<u>1,394,101</u>	<u>961,013</u>
<b>INCREASE IN CASH</b>	657,070	332,343
<b>CASH, BEGINNING OF YEAR</b>	<u>428,267</u>	<u>95,924</u>
<b>CASH, END OF YEAR</b>	<u>\$ 1,085,337</u>	<u>\$ 428,267</u>

Supplemental disclosure of non-cash financing and investing activities:

At June 30, 2007, exploration costs included in accounts payable totaled \$7,000 (2006 - \$6,618).

See accompanying notes to consolidated financial statements

**RARE ELEMENT RESOURCES LTD.**  
**CUMULATIVE SCHEDULE OF MINERAL PROPERTY COSTS**  
*(Expressed in US Dollars)*

	Balance June 30, 2005	Expenditures for the year	Balance June 30, 2006	Expenditures for the year	Balance June 30, 2007
<b>Bear Lodge Property</b>					
Property acquisition costs	\$ 17,721	\$ -	\$ 17,721	\$ -	\$ 17,721
Exploration expenditures					
Assays	3,528	4,109	7,637	114	7,751
Assessments and taxes	12,541	7,563	20,104	-	20,104
Drilling	132,013	118,396	250,409	73,513	323,922
Geological consulting	60,567	61,416	121,983	46,785	168,768
Geophysical	-	300	300	-	300
Metallurgical testing	-	-	-	38,530	38,530
Overhead expenses	7,684	805	8,489	1,190	9,679
Staking	816	17,133	17,949	-	17,949
Survey	34,338	-	34,338	-	34,338
Travel expenses	23,935	-	23,935	-	23,935
Wages	99,734	-	99,734	-	99,734
Total exploration expenditures on Bear Lodge property	392,877	209,722	602,599	160,132	762,731
<b>Kipawa Property</b>					
Exploration expenditures					
Geological consulting	-	4,949	4,949	-	4,949
Staking	-	1,308	1,308	-	1,308
Write-down of property	-	-	-	(4,841)	(4,841)
Total exploration expenditures on Kipawa property	-	6,257	6,257	(4,841)	1,416
<b>TOTAL EXPENDITURES</b>	<b>\$ 392,877</b>	<b>\$ 215,979</b>	<b>\$ 608,856</b>	<b>\$ 155,291</b>	<b>\$ 764,147</b>

See accompanying notes to consolidated financial statements

**RARE ELEMENT RESOURCES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007  
*(Expressed in US Dollars)*

**1. NATURE OF OPERATIONS**

Rare Element Resources Ltd. (“Rare Element” or “the Company”) was incorporated under the laws of the Province of British Columbia on June 3, 1999.

These consolidated financial statements have been prepared on a going-concern basis, which assumes that the Company will be able to realize its assets and discharge its liabilities in the normal course of business for the foreseeable future. The continuing operations of the Company are dependent upon its ability to continue to raise adequate financing and to commence profitable operations in the future.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Basis of presentation and principles of consolidation**

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles and are inclusive of the accounts of the Company and Paso Rico Resources Ltd. (“Paso Rico”), together with those of Paso Rico’s wholly-owned subsidiaries, Minera Santa Regina, S.A. de C.V., Compania Minera Real de las Lomas, S.A. de C.V. and Paso Rico (USA), Inc. The Company is in the process of winding down the two Mexican companies.

**Use of estimates**

The preparation of these consolidated financial statements requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the consolidated financial statements, and the reported amounts of revenues and expenses during the reported period. Actual results could differ from these estimates.

**Foreign currency translation**

The Company’s reporting currency is the US Dollar. The Company’s Canadian operations are considered to be integrated with foreign currency transactions translated into US Dollars as follows:

- monetary assets and liabilities at the rates of exchange prevailing at the balance sheet dates;
- other assets and liabilities at the applicable historical exchange rates;
- revenues and expenses at the average rates of exchange for the period, and;
- gains and losses arising from the conversion of foreign-currency balances and transactions are reported in income as they occur.

**Financial instruments**

The Company’s consolidated financial instruments include cash, accounts receivable and accounts payable and accrued liabilities. The fair market value of these financial instruments approximates their carrying value due to their short-term nature.

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**RARE ELEMENT RESOURCES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007  
*(Expressed in US Dollars)*

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued**

**Mineral properties and deferred exploration costs**

The cost of mineral properties and related exploration expenditures are deferred until the properties are placed into production, sold or abandoned. These deferred costs will be amortized over the estimated useful life of the properties following the commencement of production, or written-off if the properties, allowed to lapse, or abandoned.

Cost includes the cash consideration and the fair market value of shares issued for the acquisition of mineral properties. Properties acquired under option agreements are recorded in the accounts at such time as payments are made. Proceeds from options granted are applied to the cost of the related property and any excess is included in income for the period.

The recorded amounts of mineral claim acquisition costs and their related deferred exploration costs represent actual expenditures incurred and are not intended to reflect present or future values.

The Company reviews capitalized costs on its mineral properties periodically and will recognize an impairment in value based upon current exploration results and upon management's assessment of the future probability of profitable revenues from the property or from the sale of the property. Management's assessment of a property's estimated current fair market value may also be based upon a review of other property transactions that have occurred in the same geographic area as that of the property under review.

**Amortization**

The Company provides for amortization on its computer equipment at 30% declining balance (one-half of the rate is taken in the year of acquisition and disposition).

**Income taxes**

The Company accounts for, and measures future tax assets and liabilities in accordance with the liability method, where future income-tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amount of existing assets and liabilities and their respective tax bases. Future tax assets and liabilities are measured using enacted or substantively enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on future tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the date of enactment or substantive enactment of the change. When the future realization of income tax assets does not meet the test of being more likely than not to occur, a valuation allowance in the amount of the future benefit is taken and no asset is recognized. Such an allowance applies fully to all potential income tax assets of the Company.

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**RARE ELEMENT RESOURCES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007  
(Expressed in US Dollars)

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued**

**Loss per share**

The loss per share is computed using the weighted average number of shares outstanding during the period. Diluted loss per share is not presented as the effect on the basic loss per share would be anti-dilutive.

**Comparative figures**

Certain of the prior period's figures have been reclassified to conform with the current period's financial statement presentation.

**Stock-based compensation**

The Company recognizes compensation expense for all stock options granted using the fair value based method of accounting. Any cash paid on the exercise of stock options is added to the stated value of common shares.

**Asset retirement obligations**

The Company recognizes a liability for an asset retirement obligation when it is determinable and calculates the liability based upon undiscounted future payments. A corresponding amount is added to the carrying amount of the related long-lived asset, and this amount is subsequently allocated to expenses over its expected life. Adjustments will also be made in subsequent periods to changes in asset retirement obligations due to changes in estimates. As at June 30, 2007, the Company did not have any asset retirement obligations.

**Retirement of long-lived assets**

Long-lived assets are assessed for impairment when events and circumstances warrant, when the carrying amounts of the assets exceeds its estimated undiscounted net cash flow from use or its fair value, at which time the impairment is charged to earnings.

**3. MINERAL PROPERTIES AND DEFERRED EXPLORATION COSTS**

The amounts shown represent costs incurred to date, and do not necessarily represent present or future values as they are entirely dependent upon the economic recovery of future ore reserves. A breakdown of carrying values by period is as follows:

	2007	2006
Bear Lodge Property	\$ 762,731	\$ 602,599
Kipawa Property	1,416	6,257
	<u>\$ 764,147</u>	<u>\$ 608,856</u>

**RARE ELEMENT RESOURCES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007  
*(Expressed in US Dollars)*

**3. MINERAL PROPERTIES AND DEFERRED EXPLORATION COSTS, Continued**

**Bear Lodge Property**

The Company, through its wholly owned subsidiary, Paso Rico (USA), Inc., holds a 100% interest in a group of unpatented mineral claims, known as the Bear Lodge Property. The property is situated in the Bear Lodge Mountains of northeast Wyoming. These claims were, in part, acquired from Phelps Dodge Exploration Company ("Phelps Dodge") by way of a "Mineral Lease and Option for Deed". Some of the claims and a portion of a defined area of influence surrounding the claims are subject to a production royalty of 2% of Net Smelter Returns ("NSR") payable to Phelps Dodge. Paso Rico (USA), Inc. owns a portion of the claim group outright and these claims are not subject to the NSR.

In September 2005, the Company staked 20 additional claims at the property. The property now comprises 90 federal unpatented mineral claims and a 640-acre Wyoming state lease for a total of approximately 2,100 acres.

On June 1, 2006, Paso Rico (USA), Inc. and Newmont North America Exploration Limited ("Newmont"), a subsidiary of Newmont Mining Corporation, signed an agreement to establish a gold-exploration venture on the Company's Bear Lodge, Wyoming property ("Venture"). Under the term sheet, Newmont has the right to earn a 65% participating interest in the Bear Lodge property, excluding any rights to the rare-earth elements and uranium, but including rights to gold and other metals, if Newmont spends \$5 million on property exploration by 2011.

Newmont also has the right to earn an additional 15% participating interest by completing a positive feasibility study. If the Company's interest is reduced to 20% for any reason, the Company shall have a financing option by which it may elect for Newmont to carry the Company's share of Venture expenditures, without further dilution to the Company, until commencement of mining on the property. The funds advanced by Newmont under the financing option, plus interest at LIBOR plus 3%, shall be recouped from 90% of the Company's portion of the proceeds from production.

Newmont staked an additional 116 Federal lode mineral claims, which are included as part of the Venture's property.

Newmont is the operator of the gold-exploration program. The Company will continue to operate its rare-earth-element exploration program; however, if the two exploration programs conflict, the Venture, under Newmont, may choose to operate both programs.

All claims are located on federal lands and are subject to annual maintenance fees payable to the United States Bureau of Land Management. These fees are now paid by Newmont as long as the Newmont agreement remains in effect.

**Kipawa Property**

In April 2006, the Company acquired by staking 26 claims, totaling approximately 1,531 hectares. The property is located in Quebec, 90 km northwest of North Bay, Ontario. The Company wrote off \$4,841 in fiscal 2007 in light of the sale of the property subsequently for \$1,500 CDN (\$1,416).

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**RARE ELEMENT RESOURCES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007

*(Expressed in US Dollars)*

**4. EQUIPMENT**

	2007	2006
Computer equipment	\$ 864	\$ -
Accumulated amortization	(191)	-
Net book value	<u>\$ 673</u>	<u>\$ -</u>

**5. INVESTMENTS**

During fiscal 2007, the Company sold to Almaden Minerals Ltd. (“Almaden”) its 2% Net Smelter Return royalty (“NSR”) on a Mexican property which has been previously written off by the Company. The NSR was sold for \$20,000 and 25,000 Almaden warrants exercisable at a price of \$3.00 CDN until March 20, 2010. A fair value of \$15,083 was assigned to these warrants and was estimated using the Black-Scholes Option Pricing Model based on the following assumptions of a risk free interest rate of 3.98%, a volatility rate of 52.42% and an expected time to exercise of 3 years.

**6. RECLAMATION BOND**

The Company was required to post a reclamation bond which covers the cost to reclaim the ground disturbed during its exploration programs at the Bear Lodge Property. On July 23, 2004, \$10,000 was transferred to the Wyoming Department of Environmental Quality for the bond required to cover the exploration program. The Company must complete certain reclamation work for these funds to be released, but may leave the bond in place for future exploration programs, even if such work is completed.

In August 2006, an additional bond of \$10,000 was set up in the name of Paso Rico (USA), Inc., but it was paid by Newmont and covers Newmont’s gold-exploration reclamation work. It will revert to Newmont, if and when Newmont completes its reclamation.

**RARE ELEMENT RESOURCES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007  
*(Expressed in US Dollars)*

**7. SHARE CAPITAL**

Authorized – unlimited number of common shares without par value.

Issued and outstanding:	Number of Shares	Amount	Contributed Surplus
Balance as at June 30, 2005	14,430,825	\$ 2,501,243	\$ 64,640
Issued for cash:			
Private placement (Note 7a)	1,147,600	196,928	-
Exercise of warrants (Notes 6a and b)	2,685,000	761,852	-
Exercise of options (Note 7c)	10,000	2,233	-
Fair value of the options exercised	-	1,037	(1,037)
Stock-based compensation	-	-	52,976
Balance as at June 30, 2006	18,273,425	3,463,293	116,579
Issued for cash:			
Private placement (Note 7d)	1,666,698	897,917	-
Exercise of warrants (Notes 7a and d)	1,076,766	337,550	-
Exercise of options (Note 7e)	687,500	158,634	-
Fair value of the options exercised	-	115,992	(115,992)
Stock-based compensation	-	-	240,142
Balance as at June 30, 2007	21,704,389	\$ 4,973,386	\$ 240,729

- (a) During the year ended June 30, 2006, the Company completed a non-brokered private placement of 1,147,600 units at a price of \$0.20 CDN for gross proceeds of \$196,928 (\$229,520 CDN). Each unit is comprised of one common share and one 12-month non-transferable share purchase warrant. The share purchase warrants are exercisable into one common share at a price of \$0.30 CDN per share. 200,000 warrants were exercised in fiscal 2006 and the remaining 947,600 warrants were exercised during the year ended June 30, 2007.
- (b) During the year ended June 30, 2006, 950,000 warrants were exercised at a price of \$0.35 CDN per share and 1,535,000 warrants were exercised at a price of \$0.30 CDN per share.
- (c) During the year ended June 30, 2006, 10,000 stock options were exercised at a price of \$0.25 CDN per share. A fair value of \$1,037 was recognized on these exercised options.
- (d) During the year ended June 30, 2007, the Company closed a non-brokered private placement of 1,666,698 units at \$0.60 CDN per unit for gross proceeds of \$897,917 (\$1,000,021 CDN). Each unit comprises one common share and one-half of a non-transferable share purchase warrant. A whole warrant may be exercised to purchase one additional common share of the Company at \$0.75 CDN per share until March 22, 2008. During fiscal 2007, 129,166 of these warrants were exercised.

**RARE ELEMENT RESOURCES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007  
*(Expressed in US Dollars)*

**7. SHARE CAPITAL, Continued**

- (e) During the year ended June 30, 2007, a total of 687,500 options at prices ranging from \$0.20 CDN to \$0.55 CDN were exercised. A fair value of \$115,992 was recognized on these exercised options.

**Stock Options**

The following table summarizes the Company's stock option activity:

	Number of Shares	Weighted Average Exercise Price (CDN\$)
Outstanding, June 30, 2005	860,000	\$ 0.34
Granted	1,740,000	0.39
Expired	(10,000)	0.35
Exercised	(10,000)	0.25
Outstanding, June 30, 2006	2,580,000	0.37
Granted	440,000	0.55
Cancelled	(250,000)	0.55
Exercised	(687,500)	0.26
Outstanding, June 30, 2007	2,082,500	\$ 0.42

At June 30, 2007, the following options were outstanding:

Expiry Date	Number of Options	Exercise Price (CDN\$)
October 31, 2008	780,000	0.35
July 24, 2010	350,000	0.25
April 28, 2011	512,500	0.55
January 10, 2012	440,000	0.55
	2,082,500	

**Stock-based compensation**

The fair value of options reported as compensation expense has been estimated using the Black-Scholes Option Pricing Model using the following assumptions:

	2007	2006
Risk-free interest rate	4.08%	3.37-3.89%
Annualized volatility	88%	87-88%
Expected dividend yield	Nil	Nil
Expected option life in years	4 years	4 years

Based on these variables, stock-based compensation expense for the options vested during the year ended June 30, 2007 was \$240,142 (2006 – \$52,976).

Option pricing models require the input of highly subjective assumptions, particularly as to the expected price volatility of the stock. Changes in these assumptions can materially affect fair value estimates and, therefore, it is management's view that the existing models do not necessarily provide a single reliable measure of the fair value of the Company's stock-option grants.

**RARE ELEMENT RESOURCES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007  
*(Expressed in US Dollars)*

**7. SHARE CAPITAL, Continued**

**Warrants**

The following table summarizes the Company's warrant activity:

	Number of Shares	Weighted Average Exercise Price (CDN\$)
Outstanding, June 30, 2005	4,310,589	\$ 0.33
Expired	(1,825,589)	0.35
Exercised	(2,685,000)	0.32
Granted	1,147,600	0.30
Outstanding, June 30, 2006	947,600	0.30
Exercised	(1,076,766)	0.35
Granted	833,349	0.75
Outstanding, June 30, 2007	704,183	\$ 0.75

At June 30, 2007, the following warrants were outstanding:

Expiry Date	Number of Warrants	Exercise Price (CDN\$)
March 22, 2008	704,183	\$ 0.75

**Escrowed shares**

1,000,000 shares were placed in escrow in accordance with the escrow agreement dated August 25, 1999 and amended on July 17, 2003. 550,000 shares were released in fiscal 2004 and 2005, 300,000 in fiscal 2006, and 150,000 in July 2006.

1,336,000 shares were placed in escrow in accordance with escrow agreements dated December 10, 2002. 734,800 shares were released in fiscal 2004 and 2005, 400,800 in fiscal 2006, and 200,400 shares in July 2006.

As of June 30, 2007, there were no shares in escrow.

**8. RELATED PARTY TRANSACTIONS**

During the year ended June 30, 2007, \$74,238 (2006 - \$61,923) was charged for management fees by a private company controlled by the president. As at June 30, 2007, \$Nil (2006 - \$Nil) was owed to this private company.

During the year ended June 30, 2007, \$95,186 (2006 - \$95,034) was charged by a private company controlled by one of the directors for accounting, administrative fees and rent. As at June 30, 2007, \$8,257 (2006 - \$9,556) was owed to this private company.

During the year ended June 30, 2007, \$Nil (2006 - \$1,724) was capitalized in deferred exploration costs for geological consulting work performed by a director. As at June 30, 2007, \$Nil (2006 - \$Nil) was owed to this director.

Related party transactions are measured at the fair value amount as determined by management. The amounts bear no interest and are unsecured with no repayment terms.

**RARE ELEMENT RESOURCES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007  
*(Expressed in US Dollars)*

**9. INCOME TAXES**

A reconciliation of income tax recovery at statutory rates compared to reported income tax recovery is as follows:

	2007	2006
Loss for the year	\$ (751,496)	\$ (458,407)
Expected income tax recovery	(268,090)	(160,891)
Effect of foreign tax rate differences	5,204	(44)
Non-deductible expenses	71,696	10,260
Unrecognized benefit of non-capital losses	191,190	150,675
<b>Total income tax recovery</b>	<b>\$ -</b>	<b>\$ -</b>

The significant components of the Company's future income tax assets and liabilities at June 30, 2007 are as follows:

	2007	2006
Future income tax assets (liabilities):		
Non-capital loss carryforwards	\$ 549,188	\$ 755,971
Equipment	66	-
Resource expenses	(1,525)	(19,013)
Future income tax assets	547,729	736,958
Valuation allowance	(547,729)	(736,958)
<b>Net future income tax assets</b>	<b>\$ -</b>	<b>\$ -</b>

The following is a schedule of the Company's aggregate non-capital losses available to reduce taxable income in Canada in future years, expiring between 2008 and 2027 as follows:

<u>Year of Expiration</u>	<u>Non-Capital Loss</u> CDN\$
2008	221,394
2009	83,596
2010	58,852
2014	252,658
2015	206,028
2026	461,757
2027	543,317
	<u>\$ 1,827,602</u>

**RARE ELEMENT RESOURCES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007  
(Expressed in US Dollars)

**9. INCOME TAXES, Continued**

The future tax benefits, if any, resulting from the application of these losses have been offset by a valuation allowance, as it cannot be considered likely that these amounts will be utilized.

The following is a schedule of the Company's aggregate non-capital losses available to reduce taxable income in the United States in future years, expiring between 2014 and 2022 as follows:

<u>Year of Expiration</u>	<u>Non-Capital Loss</u> USD\$
2014	84
2015	64,995
2016	87,060
2017	34,832
2018	15,100
2019	14,952
2020	30,182
2021	37,806
2022	39,463
	<u>\$ 324,474</u>

The future tax benefits, if any, resulting from the application of these losses have been offset by a valuation allowance, as it cannot be considered likely that these amounts will be utilized.

**10. COMMITMENTS AND CONTINGENCIES**

**Potential environmental contingency**

The Company's mining and exploration activities are subject to various federal, provincial and state laws and regulations governing the protection of the environment. These laws and regulations are continually changing and generally becoming more restrictive. The Company conducts its operations so as to protect public health and the environment, and believes its operations are materially in compliance with all applicable laws and regulations. The Company has made, and expects to make in the future, expenditures to comply with such laws and regulations. The ultimate amount of reclamation and other future site-restoration costs to be incurred for existing mining interests is uncertain.

**RARE ELEMENT RESOURCES LTD.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

June 30, 2007  
*(Expressed in US Dollars)*

**11. SEGMENTED INFORMATION**

The Company operates in a single reportable operating segment, being exploration and development of mineral properties.

Summarized financial information for the geographic segments the Company operates in are as follows:

	Canada	United States	Total
<u>As at June 30, 2007</u>			
Assets	\$ 1,156,505	\$ 812,814	\$ 1,969,319
<u>As at June 30, 2006</u>			
Assets	\$ 482,141	\$ 612,599	\$ 1,094,740
<u>For the year ended June 30, 2007</u>			
Loss for the period	\$ 751,106	\$ 390	\$ 751,496
Capital expenditures	\$ 864	\$ 159,750	\$ 160,614
<u>For the year ended June 30, 2006</u>			
Loss for the period	\$ 458,117	\$ 290	\$ 458,407
Capital expenditures	\$ 6,257	\$ 209,722	\$ 211,641

**12. SUBSEQUENT EVENTS**

On October 1, 2007, the Company granted a total of 725,000 options at a price of \$1.00 CDN to a new president and consultants.

On October 12, 2007, the Company signed a sale and purchase agreement to sell the Kipawa property for \$1,500 CDN in cash.

In October, 2007, the Company arranged a non-brokered private placement of 1 million units for gross proceeds of \$1 million CDN. Each unit is comprised of one common share and one half of one non-transferable warrant. Each warrant entitles the holder to purchase one additional common share for a period of 18 months at a price of \$1.35 CDN per common share.

Subsequent to June 30, 2007, 326,500 stock options were exercised at prices ranging from \$0.25 CDN to \$0.55 CDN and 41,667 warrants were exercised at \$0.75 CDN.