

RARE ELEMENT RESOURCES LTD.
CONSOLIDATED FINANCIAL STATEMENTS
For the years ended June 30, 2008 and 2007

DE VISSER GRAY LLP

CHARTERED ACCOUNTANTS

401 - 905 West Pender Street
Vancouver, BC Canada
V6C 1L6
Tel: (604) 687-5447
Fax: (604) 687-6737

AUDITORS' REPORT

To the Shareholders of Rare Element Resources Ltd.,

We have audited the balance sheets of Rare Element Resources Ltd. as at June 30, 2008 and 2007 and the statements of operations and deficit and cash flows for each of 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 Canadian generally accepted auditing standards. 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 financial statements present fairly, in all material respects, the financial position of the Company as at June 30, 2008 and 2007 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 27, 2008

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

As of June 30

(Expressed in US Dollars)

	2008	2007
ASSETS		
CURRENT		
Cash and cash equivalents	\$ 2,271,917	\$ 1,085,337
Accounts receivable	46,726	44,428
Prepaid expenses	26,883	49,651
	2,345,526	1,179,416
Equipment (Note 4)	4,267	673
Investment (Note 5)	15,083	15,083
Mineral properties and deferred exploration costs (Note 3)	1,019,349	764,147
Reclamation bond (Note 6)	10,000	10,000
	\$ 3,394,225	\$ 1,969,319
LIABILITIES		
CURRENT		
Accounts payable and accrued liabilities	\$ 48,594	\$ 16,456
Due to related parties (Note 8)	15,257	8,257
	63,851	24,713
SHAREHOLDERS' EQUITY		
SHARE CAPITAL (Note 7)	6,574,447	4,973,386
CONTRIBUTED SURPLUS (Note 7)	879,302	240,729
DEFICIT	(4,123,375)	(3,269,509)
	3,330,374	1,944,606
	\$ 3,394,225	\$ 1,969,319
NATURE OF OPERATIONS (Note 1)		
COMMITMENTS AND CONTINGENCIES (Note 10)		

APPROVED BY THE BOARD OF DIRECTORS:

“Donald E. Ranta”

Donald E. Ranta

“Mark T. Brown”

Mark T. Brown

See accompanying notes to consolidated financial statements

RARE ELEMENT RESOURCES LTD.
CONSOLIDATED STATEMENTS OF OPERATIONS AND DEFICIT
For the years ended June 30
(Expressed in US Dollars)

	2008	2007
EXPENSES		
Audit and legal	\$ 22,684	\$ 32,025
Accounting and administrative fees (Note 8)	94,507	87,232
Amortization	2,117	191
Bank charges	1,584	1,023
Foreign-exchange loss (gain)	(88,985)	43,589
Investor relations and shareholder communication	185,726	204,362
Management fees (Note 8)	124,878	74,238
Office and miscellaneous	40,562	37,298
Rent (Note 8)	7,431	7,954
Stock-based compensation	423,891	240,142
Transfer and listing fees	30,628	29,166
Travel	38,629	24,518
Write-down of mineral properties (Note 3)	-	4,841
	<u>(883,652)</u>	<u>(786,579)</u>
OTHER ITEM		
Interest income	29,786	35,083
	<u>29,786</u>	<u>35,083</u>
NET LOSS FOR THE YEAR	(853,866)	(751,496)
DEFICIT, BEGINNING OF YEAR	<u>(3,269,509)</u>	<u>(2,518,013)</u>
DEFICIT, END OF YEAR	<u>\$ (4,123,375)</u>	<u>\$ (3,269,509)</u>
LOSS PER SHARE – BASIC AND DILUTED	<u>\$ (0.04)</u>	<u>\$ (0.04)</u>
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING	<u>22,972,529</u>	<u>20,412,956</u>

See accompanying notes to consolidated financial statements

RARE ELEMENT RESOURCES LTD.
CONSOLIDATED STATEMENTS OF CASH FLOWS
For the years ended June 30
(Expressed in US Dollars)

	2008	2007
CASH PROVIDED BY (USED IN) OPERATIONS		
Net loss for the year	\$ (853,866)	\$ (751,496)
Items not involving cash:		
Amortization	2,117	191
Fair value of warrants received pursuant to the sale of mineral property	-	(15,083)
Stock-based compensation	423,891	240,142
Write-down of mineral properties	-	4,841
	<u>(427,858)</u>	<u>(521,405)</u>
Changes in non-cash working-capital items:		
Accounts receivable	(2,298)	(20,016)
Prepaid expenses	22,768	(26,446)
Accounts payable and accrued liabilities	32,138	(7,251)
Due to related parties	7,000	(1,299)
	<u>(368,250)</u>	<u>(576,417)</u>
INVESTING ACTIVITIES		
Deferred exploration costs	(256,618)	(159,750)
Purchase of equipment	(5,711)	(864)
	<u>(262,329)</u>	<u>(160,614)</u>
FINANCING ACTIVITIES		
Cash received for common shares	1,831,259	1,394,101
Share issue costs	(15,516)	-
Cash received for sale of mineral property	1,416	-
	<u>1,817,159</u>	<u>1,394,101</u>
INCREASE IN CASH AND CASH EQUIVALENTS	1,186,580	657,070
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	<u>1,085,337</u>	<u>428,267</u>
CASH AND CASH EQUIVALENTS, END OF YEAR	<u>\$ 2,271,917</u>	<u>\$ 1,085,337</u>
Cash and cash equivalents consist of:		
Cash	786,917	1,085,337
GIC Investments	1,485,000	-
	<u>\$ 2,271,917</u>	<u>\$ 1,085,337</u>

See accompanying notes to consolidated financial statements

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

	Balance June 30, 2006	Expenditures for the year	Balance June 30, 2007	Expenditures for the year	Balance June 30, 2008
Bear Lodge Property					
Property acquisition costs	\$ 17,721	\$ -	\$ 17,721	\$ -	\$ 17,721
Exploration expenditures					
Assays	7,637	114	7,751	5,623	13,374
Assessments and taxes	20,104	-	20,104	-	20,104
Drilling	250,409	73,513	323,922	136,038	459,960
Geological consulting	121,983	46,785	168,768	58,714	227,482
Geophysical	300	-	300	-	300
Metallurgical testing	-	38,530	38,530	55,000	93,530
Overhead expenses	8,489	1,190	9,679	1,160	10,839
Staking	17,949	-	17,949	-	17,949
Survey	34,338	-	34,338	-	34,338
Travel expenses	23,935	-	23,935	83	24,018
Wages	99,734	-	99,734	-	99,734
Total exploration expenditures on Bear Lodge property	602,599	160,132	762,731	256,618	1,019,349
Kipawa Property					
Exploration expenditures					
Geological consulting	4,949	-	4,949	-	4,949
Staking	1,308	-	1,308	-	1,308
Write-down/proceeds of property	-	(4,841)	(4,841)	(1,416)	(6,257)
Total exploration expenditures on Kipawa property	6,257	(4,841)	1,416	(1,416)	-
TOTAL EXPENDITURES	\$ 608,856	\$ 155,291	\$ 764,147	\$ 255,202	\$ 1,019,349

See accompanying notes to consolidated financial statements

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008
(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.

The Company is in the process of exploring its mineral property interests and has not yet determined whether its mineral property interests contain mineral reserves that are economically recoverable. The Company’s continuing operations and the underlying value and recoverability of the amounts shown for mineral property interests are entirely dependent upon the existence of economically recoverable mineral reserves, the ability of the Company to obtain the necessary financing to complete the exploration and development of the mineral property interests, obtaining the necessary permits to mine, and on future profitable production or proceeds from the disposition of the mineral property interests.

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.

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 are allowed to lapse or are 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.

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008
(Expressed in US Dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

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.

Cash and cash equivalents

Provided that the instruments are readily convertible at the balance sheet date into cash without penalty at their carrying value, the Company considers its highly liquid term investments, typically with Canadian Chartered banks, to be cash equivalents. The Company maintains its cash and cash equivalents in bank deposit accounts which exceed federally insured limits. At June 30, 2008, the Company had its cash and cash equivalents with one financial institution. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant credit risk on cash and cash equivalents.

Amortization

The Company provides for amortization on its computer equipment at 55%, and software at 100%, 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.

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.

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008
(Expressed in US Dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Stock-based compensation

The Company recognizes compensation expense for all stock options granted using the fair value based method of accounting. Under the fair value method, stock-based payments are measured at the fair value of the consideration received or the fair value of the equity instruments issued or liabilities incurred, whichever is more reliably measurable, and are charged to operations over the vesting period. The offset is initially credited to contributed surplus and subsequently transferred to share capital if and when the related options are exercised. Cash received on the exercise of stock options is also credited to share capital.

Asset retirement obligations

The Company recognizes the fair value of a liability for an asset retirement obligation in the year in which it is incurred when a reasonable estimate of fair value can be made.

Asset retirement obligations, continued

The associated asset retirement costs are capitalized as part of the carrying amount of long lived assets. The liability is accreted over the estimated time period until settlement of the obligation and asset is depreciated over the estimated remaining useful life of the asset. Changes in the liability for an asset retirement obligation due to the passage of time will be measured by applying an interest method of allocation. The amount will be recognized as an increase in the liability and an accretion expense in the statement of operations. Changes resulting from revisions to the timing or the amount of the original estimate of undiscounted cash flows are recognized as an increase or a decrease in the carrying amount of the liability and the related capitalized asset retirement cost.

Comparative figures

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

Financial Instruments and Comprehensive Income

Effective July 1, 2007, the Company adopted new Recommendations issued by the Canadian Institute of Chartered Accountants (CICA) as follows: Section 1530, Comprehensive Income; Section 3251, Equity; Section 3855, Financial Instruments - Recognition and Measurement retroactively without restatement. Section 1530 establishes standards for reporting and presenting comprehensive income, which is defined as the change in equity from transactions and other events occurring with non-owner sources. Other comprehensive income refers to items recognized in comprehensive income that are excluded from net income calculated in accordance with generally accepted accounting principles. Under the new standards, policies followed for periods prior to the effective date generally are not reversed and, therefore, the comparative figures have not been restated. The adoption of these Recommendations had no impact on opening deficit.

Under Section 3855, financial instruments must be classified into one of the following five categories: held-for-trading, held-to-maturity, loans and receivables, available-for-sale financial assets or other financial liabilities. All financial instruments, including derivatives, are measured in the balance sheet at fair value except for loans and receivables, held-to-maturity investments and other financial liabilities which are measured at amortized cost. Subsequent measurement and changes in fair value will depend on their initial classification, as follows: held-for-trading financial assets are measured at fair value and changes in fair value are recognized in net income; available-for-sale financial instruments are measured at fair value with changes in fair value recorded in other comprehensive income until the investment is derecognized or impaired at which time the amounts would be recorded in net income.

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008
(Expressed in US Dollars)

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES, Continued

Upon adoption of these new standards, the Company designated its cash and cash equivalents as held-for-trading, which means that it is measured at fair value. Accounts receivable was classified as loans and receivables, and therefore measured at amortized cost. Accounts payable and accrued liabilities and due from related parties were classified as other financial liabilities. The Company's investment is considered to be "held for trading" however the difference between its current fair value and that recorded upon initial recognition in fiscal 2007 is considered to be immaterial to adjust for. The Company had neither available-for-sale nor held-to-maturity instruments during the year ended June 30, 2008.

Financial Instruments and Comprehensive Income, continued

The Company had no balances or transactions involving "other comprehensive income or loss" at the beginning or during the year ended June 30, 2008, and no opening or closing balances of "accumulated other comprehensive income or loss".

Changes in accounting policies

Accounting changes

On July 1, 2007, the Company adopted new Section 1506, Accounting Changes. The main features of this section are as follows:

- Voluntary changes in accounting policy are made only if they result in the financial statements providing reliable and more relevant information;
- Changes in accounting policies are applied retroactively unless doing so is impracticable;
- Prior period errors are corrected retroactively; and
- New disclosures are required in respect of changes in accounting policies, changes in accounting estimates and correction of errors.

New accounting pronouncements

(a) Capital disclosures

Effective June 30, 2008, the Company will adopt Section 1535 of the CICA Handbook, Capital Disclosures. This section establishes standards for disclosing information about an entity's capital and how it is managed. The Company will implement these disclosures in the first quarter of 2009. The main features of this new section are:

- Provide information that enables users of the Company's financial statements to evaluate the entity's objectives, policies and processes for managing capital;
 - Summary quantitative data about what the entity manages as capital;
 - Whether the entity has complied with any capital requirements; and
 - If it has not complied, the consequences of non-compliance.
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RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008
(Expressed in US Dollars)

2. SIGNIFICANT ACCOUNTING POLICIES, Continued

New accounting pronouncements, continued

(b) Financial instrument disclosures

In March 2007, the CICA issued Section 3862, Financial Instruments - Disclosures, and Section 3863, Financial instruments - Presentation, which together comprise a complete set of disclosure and presentation requirements that revise and enhance current disclosure requirements for financial instruments. Section 3862 requires disclosure of additional detail by financial asset and liability categories. Section 3863 establishes standards for presentation of financial instruments and non-financial derivatives. It deals with the classification of financial instruments, from the perspective of the issuer, between liabilities and equity, the classification of related interest, dividends, losses and gains, and the circumstances in which financial assets and financial liabilities are offset.

The Company will implement these disclosures in the first quarter of fiscal 2009, although the adoption of this section will not impact the financial results of the Company.

(c) Goodwill and intangible assets

In February 2008, the CICA issued Section 3064, Goodwill and Intangible Assets, replacing Section 3062, Goodwill and Other Intangible Assets, and Section 3450, Research and Development Costs. The new pronouncement establishes standards for the recognition, measurement, presentation, and disclosure of goodwill and intangible assets by profit-oriented enterprises. This section also applies to goodwill subsequent to its initial recognition. Section 3064 also applies to accounting for intangible assets, except intangible assets that are within the scope of another section. This section is effective in the first quarter of 2009; the adoption of this section is not expected to impact the financial results of the Company.

(d) Business combinations

The proposed amended recommendations of the CICA for accounting for business combinations will apply to the Company's business combinations, if any, with an acquisition date subsequent to the effective date. Whether the Company would be materially affected by the proposed amended recommendations would depend upon the specific facts of the business combinations, if any. Generally, the proposed recommendations will result in measuring business acquisitions at the fair value of the acquired entities and a prospectively applied shift from a parent company conceptual view of consolidation theory (which results in the parent company recording the book values attributable to non-controlling interests) to an entity conceptual view (which results in the parent company recording the fair values attributable to non-controlling interests). Adoption of this section is not expected to impact the Company.

(e) Convergence with International Financial Reporting Standards

In February 2008, the Canadian Accounting Standards Board confirmed that the use of International Financial Reporting Standards ("IFRS") would be required for Canadian publicly accountable enterprises for years beginning on or after January 1, 2011. The conversion to IFRS will affect interim and annual financial statements relating to the Company for the year commencing July 1, 2011. The Company is currently evaluating the impact of adopting IFRS.

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008
(Expressed in US Dollars)

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 summary of carrying values by property is as follows:

	2008	2007
Bear Lodge Property	\$ 1,019,349	\$ 762,731
Kipawa Property	-	1,416
	<u>\$ 1,019,349</u>	<u>\$ 764,147</u>

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 Crook County, 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". Certain 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") royalty payable to Phelps Dodge (now Freeport McMoRan Copper & Gold). Paso Rico (USA), Inc. also owns a portion of the claim group outright and these claims are not subject to the NSR.

The property 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 agreement, 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, by spending \$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%, 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. The total Venture area of interest consists of approximately nine square miles, mostly located in the north portion of the Bear Lodge Mountains.

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

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008
(Expressed in US Dollars)

3. MINERAL PROPERTIES AND DEFERRED EXPLORATION COSTS, Continued

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 the property 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 upon making an agreement to sell the property. On October 12, 2007, the Company sold the property for its residual carrying amount of \$1,500 CDN (\$1,416).

4. EQUIPMENT

	2008	2007
Computer equipment	\$ 4,962	\$ 864
Software	1,338	-
Accumulated amortization	(2,033)	(191)
Net book value	<u>\$ 4,267</u>	<u>\$ 673</u>

5. INVESTMENT

During fiscal 2007, the Company sold to Almaden Minerals Ltd. ("Almaden") its 2% NSR royalty 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: A risk free interest rate of 3.98%, a volatility rate of 52.42% and an expected time to exercise of 3 years.

Almaden has an officer in common with the Company.

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, covers Newmont's gold-exploration reclamation work and is not included in these financial statements. It will revert to Newmont if and when Newmont completes its reclamation.

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008
(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, 2006	18,273,425	\$ 3,463,293	\$ 116,579
Issued for cash:			
Private placement (Note 7a)	1,666,698	897,917	-
Exercise of warrants (Notes 7a and b)	1,076,766	337,550	-
Exercise of options (Note 7c)	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
Issued for cash:			
Private placement (Note 7e)	1,075,000	813,243	337,114
Exercise of warrants (Note 7a)	700,847	520,810	-
Exercise of options (Note 7d)	386,500	160,092	-
Fair value of the options exercised	-	122,432	(122,432)
Share issue costs	-	(15,516)	-
Stock-based compensation	-	-	423,891
Balance as at June 30, 2008	23,866,736	\$ 6,574,447	\$ 879,302

- (a) 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. 129,166 of these warrants were exercised during fiscal 2007, 700,847 warrants were exercised in fiscal 2008, and 3,336 warrants expired unexercised.
- (b) During the year ended June 30, 2007, 947,600 warrants were exercised at \$0.30 CDN.
- (c) 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 for proceeds of \$158,634. A fair value of \$115,992 recognized on the vesting of these options was transferred from contributed surplus.
- (d) During the year ended June 30, 2008, a total of 386,500 options at prices ranging from \$0.25 CDN to \$0.55 CDN were exercised for proceeds of \$160,092. A fair value of \$122,432 recognized on the vesting of these options was transferred from contributed surplus.
- (e) On November 5, 2007, the Company completed a non-brokered private placement for \$1,075,000 CDN. The offering consists of 1,075,000 units at \$1.00 CDN per unit. 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 \$1.35 CDN until May 5, 2009. Of total cash proceeds received of \$1,150,357, an aggregate fair value of \$337,114 was assigned to these warrants using the Black-Scholes Option Pricing Model.

RARE ELEMENT RESOURCES LTD.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2008
(Expressed in US Dollars)

7. SHARE CAPITAL, Continued

Stock Options

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

	Number of Shares	Weighted Average Exercise Price (CDN\$)
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
Granted	850,000	1.02
Exercised	(386,500)	0.42
Outstanding, June 30, 2008	2,546,000	0.62

At June 30, 2008, the following options were outstanding:

Expiry Date	Number of Options	Exercise Price (CDN\$)
October 31, 2008	750,000	0.35
July 24, 2010	200,000	0.25
April 28, 2011	350,000	0.55
January 10, 2012	396,000	0.55
September 1, 2012	350,000	1.00
October 12, 2012	350,000	1.00
October 15, 2012	25,000	1.00
November 17, 2012	50,000	1.15
February 19, 2013	75,000	1.15
	2,546,000	

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:

	2008	2007
Risk-free interest rate	3.03 – 4.29%	4.08%
Annualized volatility	86 – 89%	88%
Expected dividend yield	Nil	Nil
Expected option life in years	5 years	4 years

Based on these variables, stock-based compensation expense for the options vested during the year ended June 30, 2008 was \$423,891 (2007 – \$240,142).

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.

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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, 2006	947,600	0.30
Exercised	(1,076,766)	0.35
Granted	833,349	0.75
Outstanding, June 30, 2007	704,183	0.75
Exercised	(700,847)	0.75
Expired	(3,336)	0.75
Granted	537,500	1.35
Outstanding, June 30, 2008	537,500	1.35

At June 30, 2008, the following warrants were outstanding:

Expiry Date	Number of Warrants	Exercise Price (CDN\$)
May 5, 2009	537,500	1.35

8. RELATED PARTY TRANSACTIONS

During the year ended June 30, 2008, \$55,861 (2007 - \$74,238) was charged for management fees by a private company controlled by the former president. As at June 30, 2008, \$Nil (June 30, 2007 - \$Nil) was owed to this private company.

During the year ended June 30, 2008, \$69,017 (2007 - \$Nil) was charged for management fees by one of the directors and officers. As at June 30, 2008, \$8,500 (June 30, 2007 - \$Nil) was owed to the officer.

During the year ended June 30, 2008, \$101,938 (2007 - \$95,186) was charged by a private company controlled by one of the directors and officers for accounting, management fees and rent. As at June 30, 2008, \$6,757 (June 30, 2007 - \$8,257) was owed to this private company.

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

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9. INCOME TAXES

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

	2008	2007
Loss for the year	\$ (853,866)	\$ (751,496)
Expected income tax recovery	(268,714)	(268,090)
Effect of foreign tax rate differences	(121)	5,204
Non-deductible expenses	122,998	71,696
Unrecognized benefit of non-capital losses	145,837	191,190
Total income tax recovery	\$ -	\$ -

The significant components of the Company's future income tax assets and liabilities are as follows:

	2008	2007
Future income tax assets (liabilities):		
Non-capital loss carryforwards	\$ 479,399	\$ 549,188
Equipment	-	66
Resource expenses	(687)	(1,525)
Future income tax assets	478,712	547,729
Valuation allowance	(478,712)	(547,729)
Net future income tax assets	\$ -	\$ -

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 2009 and 2028 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	558,660
2028	422,521
	<u>\$ 2,265,466</u>

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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 2023 as follows:

<u>Year of Expiration</u>	<u>Non-Capital Loss</u>
2014	84
2015	64,995
2016	87,060
2017	34,832
2018	22,351
2019	14,952
2020	15,091
2021	37,806
2022	23,795
2023	84,953
	<u>\$ 385,919</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.

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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
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<u>As at June 30, 2008</u>			
Assets	\$ 2,349,794	\$ 1,044,431	\$ 3,394,225
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<u>As at June 30, 2007</u>			
Assets	\$ 1,156,505	\$ 812,814	\$ 1,969,319
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	Canada	United States	Total
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<u>For the year ended June 30, 2008</u>			
Loss for the year	\$ 853,062	\$ 804	\$ 853,866
Capital expenditures	\$ 5,711	\$ 256,617	\$ 262,328
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<u>For the year ended June 30, 2007</u>			
Loss for the year	\$ 751,106	\$ 390	\$ 751,496
Capital expenditures	\$ 864	\$ 159,750	\$ 160,614
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