BUILDING ON YOUR SUCCESS

2002 Annual Report

Community Bank System, Inc.

A few years ago, we at Community Bank System (NYSE: CBU) carefully surveyed our markets and our industry, and developed a four-point growth strategy that we believed would take this company to new levels of strength and performance. And it has. | 2002 was a particularly gratifying year for CBU, as we achieved our best results to date. Together our team of employees generated not only record earnings, but earnings that **more than doubled** last year's efforts – all during one of the most challenging and uncertain economies this nation has ever seen. In short, we have done exactly what we said we would do. | How did we do this? Yes, we focused on each of the four "prongs" of our growth strategy (you'll see them highlighted on page 9), and executed them with our best efforts. But above all, we promised ourselves that we would never compromise the service and attention we paid to those who mean the most to us: our customers and investors. We knew that as long as we made decisions with their best interests in mind, the rest would take care of itself. And it has. | In the following pages, you'll get to know some of our best success stories – those of our customers – and you'll gain a sense for the very essence of our company. If you are a customer or an investor, you probably know some of this first hand, as you've benefited from our approach and shared in our results. If you are not, that's OK – because by no means are we ready to rest. We enter 2003 with as much excitement and motivation as ever, ready to continue our growth and success by doing what we've always done: Building On Your Success.

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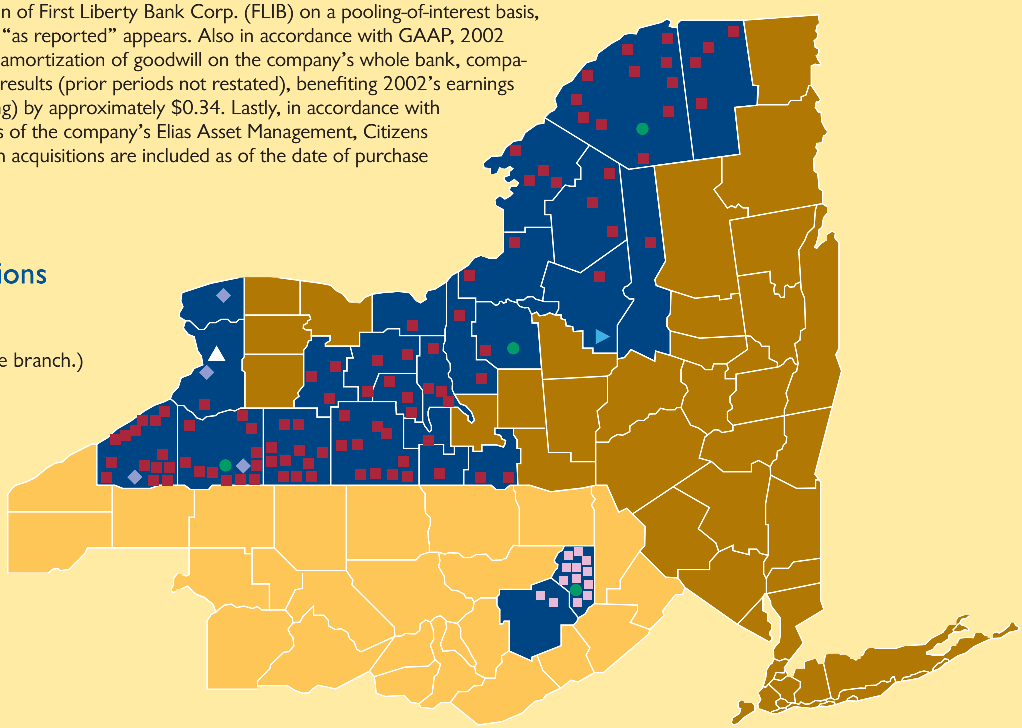
Financial Highlights

	2002	2001	Percent Change	2000	1999	1998	1997	5-Year CAGR
Income Statement Data in thousands								
Net interest income	$ 127,850	$ 96,655	32.3%	$ 90,433	$88,000	$ 84,087	$82,617	9.1%
Noninterest income (excludes securities gains/losses)	30,927	26,504	16.7	23,284	18,153	16,812	14,057	17.1
Net income	38,517	19,129	101.4	24,899	23,662	19,729	20,682	13.2
Net income – operating	38,942	24,052	61.9	25,136	23,662	20,378	20,682	13.5
Net income – cash	42,133	23,474	79.5	27,795	26,480	22,562	23,015	12.9
Net income – cash operating	$ 42,558	$ 28,397	49.9	$ 28,032	$26,480	$ 23,211	$23,015	13.1
Avg. common shares outstanding	13,167	11,825	11.5%	10,737	10,861	11,260	11,239	3.2%
Common Per Share Data diluted								
Net income	$ 2.93	$ 1.62	80.9%	$ 2.32	$ 2.18	$ 1.75	$ 1.84	9.8%
Net income – operating	2.96	2.03	45.8	2.34	2.18	1.81	1.84	10.0
Net income – cash	3.20	1.99	60.8	2.59	2.44	2.00	2.05	9.3
Net income – cash operating	3.23	2.40	34.6	2.61	2.44	2.06	2.05	9.5
Cash dividend declared	1.12	1.08	3.7	1.04	0.96	0.86	0.76	8.1
Common stock price*	31.35	26.20	24.1	24.75	23.13	29.31	31.31	3.8
Period-end book value – stated	25.04	20.77	20.6	19.11	15.55	16.50	15.62	9.9
Period-end book value – tangible	$ 14.66	$ 9.74	50.5%	$ 13.88	$ 10.47	$ 11.02	$ 9.85	8.3%
End of Period Balance Sheet Data (in millions)								
Total assets	$ 3,434	$ 3,211	6.9%	$ 2,651	$ 2,494	$ 2,296	$ 2,219	9.1%
Loans, net of unearned discount	1,807	1,733	4.3	1,516	1,426	1,293	1,204	8.5
Deposits	2,505	2,546	-1.6	1,949	1,845	1,875	1,830	6.5
Assets under management**	1,364	1,385	-1.5	1,282	583	337	274	37.9
CBU equity market value (NYSE)***	$ 407	$ 338	20.4%	$ 173	$ 164	$ 214	$ 238	11.4%

*One- and five-year returns on CBU stock price include dividend reinvestment.
**Held in fiduciary or agency capacity; 1997-1999 as reported.
***Based on actual CBU shares outstanding (not restated).

In accordance with Generally Accepted Accounting Principles (GAAP), all historical results throughout this Annual Report have been restated to include the 2001 acquisition of First Liberty Bank Corp. (FLIB) on a pooling-of-interest basis, except as noted in certain tables where the term "as reported" appears. Also in accordance with GAAP, 2002 adoption of SFAS 142 and 147 (which eliminates amortization of goodwill on the company's whole bank, company, and branch acquisitions) impacts only 2002's results (prior periods not restated), benefiting 2002's earnings per share (net income and net income – operating) by approximately $0.34. Lastly, in accordance with GAAP purchase accounting treatment, the results of the company's Elias Asset Management, Citizens National Bank of Malone, and FleetBoston branch acquisitions are included as of the date of purchase (history not restated).

Community Bank System Locations



- ■ Community Bank, N.A. Branches (Certain areas are serviced by more than one branch.)
- ● Administrative/Operations Center Locations
- ▶ Benefit Plans Administrative Services, Inc. (BPA)
- ◆ Community Investment Services, Inc. (CISI)
- △ Elias Asset Management, Inc. (EAM)
- ■ First Liberty Bank & Trust Branches (A division of Community Bank, N.A.)

BUILDING ON YOUR SUCCESS

It's satisfying to be able to begin an annual letter to shareholders by saying that the past year was a success – and by all measures, 2002 was just that for Community Bank System (CBU).

We enjoyed success on many fronts, including revenue growth, expense reduction, and ultimately, total return to shareholders. And we did so during one of the more challenging economic environments in recent memory. Our success was in large part possible because of the success of our customers and the successful efforts of our employees, and it is with that in mind that the theme of this year's Annual Report to you is "Building on Your Success."

2002 evidenced the early success of the three record-breaking acquisitions that your company completed during 2001, which together added $1.2 billion in assets and expanded our branch network by 70%. These transactions included The Citizens National Bank of Malone, which nicely extended our historically-dominant Northern New York franchise; First Liberty Bank Corp., based in the Scranton/Wilkes Barre area of Northeastern Pennsylvania, our first out-of-state acquisition and stepping stone for further potential expansion in Pennsylvania; and 36 branches with associated deposits and loans from FleetBoston Financial, which wonderfully solidified our Central and Southwestern New York footprint.

The successful and complete integration of 2001's acquisitions into our well-established core business contributed to record operating earnings of $2.96 per share in 2002, which during the third quarter featured the elimination of the acquisitions' initial and short-term dilutive effect on earnings. These record earnings include the beneficial effects of accounting standards (SFAS 142 and 147) permitting the non-amortization of goodwill associated with whole bank, company and branch acquisitions, for which we and other bankers worked assiduously during the past several years.

Our loan and deposit operations centers in Olean and Canton, New York, consolidated and upgraded during the latter half of 2001, are effectively and efficiently supporting the expanded branch network. Branch employees who joined us as a key element of the acquisitions have been thoroughly trained from both a sales and operating perspective

PERFORMANCE HIGHLIGHTS

Near-term Accomplishments

- Generated record operating earnings per share of $2.96 in 2002 — up 46% from 2001.
- Fully assimilated 2001's acquisitions and absorbed their initial dilutive impact on earnings.
- Streamlined our loan and deposit operations centers into single, centralized locations, lowering unit processing costs and facilitating future growth.
- Produced a total return to shareholders (including dividend reinvestment) of 24.1% in 2002 – during a highly challenging period for U.S. equity markets.

Long-term Accomplishments*

- Have more than doubled our noninterest income in only four years, from $15.1 million in 1998 to $30.9 million in 2002.
- Increased our total households served from 111,000 to over 195,000 in just five years.
- Made 10 successful acquisitions in the last nine years, including two financial services providers and 93 branches.
- Total loans exceed $1.8 billion – representing a five-year compound annual growth rate of 16.5%, including acquisitions and organic growth.

* Base period data as reported

and are rapidly becoming fully productive in Community Bank's brand of local, responsive decision-making. The evidence of that productivity is reflected by an annualized growth rate of 6.4% in total loans in the last nine months of 2002 compared to a decline in the first quarter. The foundation for building future financial success is firmly in place.

As a result of strong earnings, a planned reduction in the investment portfolio in the latter half of the year, and a substantial increase in the market value of that portfolio, our capital position, as measured by the tangible equity-to-assets ratio, increased a meaningful 168 basis points during the year to 5.77% at December 31, 2002. Tangible equity itself climbed by $65 million or 51%. Building capital at such growth rates provides additional strength and flexibility to our balance sheet and positions us to continue making appropriate and prudent investments in the business to enhance future success.

The economies of New York and Pennsylvania in 2002 mirrored that of the national economy. While loan growth for the year at 4.3% was modest, the improved annualized rate of 6.4% for the last three

Operating Earnings Per Share

5-year CAGR 10.0%

*Based on 10.1% more average shares outstanding due to secondary offering

Total Assets in billions

5-year CAGR 9.1%

quarters of the year provides encouragement for fully capitalizing on loan growth opportunities from 2001's acquisitions. Historically, the benefit of our acquisitions – which have added over 90 branches since 1994 through eight transactions – has been to fill in or extend our market areas, enabling a greater rate of loan growth and profitability than otherwise supported by our existing footprint.

As noted in earnings releases during the year, we experienced a few isolated charge-offs from a handful of commercial loans. This produced bank-wide net charge-offs at 0.56% of average loans outstanding for the year, moderately above our previous five-year average of 0.41%. A continuing commitment to strong asset quality, coupled with a disciplined approach to determining the appropriate allowance for loan losses, produced a year-end coverage ratio of 213% for the allowance to nonperforming assets. This is entirely consistent with our five-year results. Moreover, the allowance to total loans ratio finished the year at 1.46%, its strongest level since 1997.

Also during 2002, customers used our suite of electronic banking products more and more, as convenience and accessibility continue to be important attributes. We are also pleased that customer demand for our financial services products remains strong, as reflected by solid revenues and growth in earnings contribution from our benefits administration, broker-dealer and personal trust businesses. Elias Asset Management, our institutional and high net worth investment manager, has done a remarkable job of customer retention and new account acquisition during another difficult and challenging year for equity markets.

CBU's stock has performed especially well for investors, particularly in the context of such adverse equity market conditions. Total return to shareholders in 2002, including reinvestment of dividends, was 24.1% – well above the general market and median returns for our peer banks, and clearly a successful outcome for all our investors. Our three- and ten-year total returns have been 15.1% and 14.3%, respectively, also above peer norms and major market indices.

We fully recognize that current and future success is attributable to the consistent and responsible leadership of the Board of Directors and the commitment to excellence in execution of our strategy by our tremendous team of employees. As reported during 2002, we will be hiring a new Chief Financial Officer to replace David Wallace, who is retiring to Florida after fourteen years of energetic service to Community Bank System.

FUTURE PERFORMANCE OBJECTIVES

Near-term Objectives

- Strengthen and deepen CBU's executive management, with a replacement of our retiring Chief Financial Officer.
- Build successfully on the expanded franchise created by 2001's acquisitions, preparing to capitalize on opportunities as economic growth resumes.
- Ensure maintenance of asset quality standards at our expanding company via a new senior credit administrator position and broader loan review activities.
- Improve the return on revenue of our financial services businesses, emphasizing customer retention and business development strategies.

Long-term Objectives

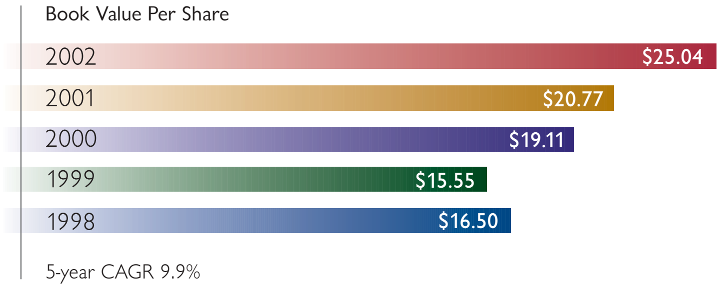
- Grow total assets to $5.0 billion by 2008.
- Derive 40% of revenue from noninterest income sources within five to ten years, including the contribution of financial services acquisitions.
- Expand upon our established presence in the Northeastern Pennsylvania market, maintaining an eye for potential bank and branch acquisitions.
- Reach a total stock market capitalization of $500 million by 2005.

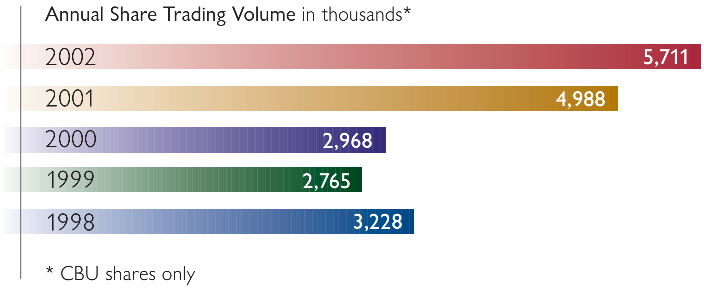
To be sure, 2002 was a success for CBU – but make no mistake, we are by no means ready to rest. The accomplishments we've enjoyed recently are the result of a great deal of hard work and planning, some of which came to fruition many years after our original actions. This year's activities also contained a good measure of resource building and forward planning on our part.

We remain confident as ever that we can continue to build on our success, by helping you – our investors and customers – to succeed. If we keep doing that, the rest will take care of itself.

James A. Gabriel
Chairman of the Board

Sanford A. Belden
President and Chief Executive Officer





Total Return to Shareholders

		Bank Stock Comparison (b)		General Market Indices Comparison (b)		
	CBU(a)(b)	Peer Average(c)	Difference (% points)	S&P 500	NASDAQ	DJIA
One Year	24.1%	12.7%	11.4%	-22.0%	-31.2%	-14.9%
Three Years	15.1%	10.1%	5.0%	-14.5%	-30.8%	-8.5%
Five Years	3.8%	3.8%	0.0%	-0.6%	-2.9%	2.9%
Ten Years	14.3%	13.7%	0.6%	9.3%	7.0%	12.0%

(a) CBU share price of $31.35 at 12/31/02
(b) Assumes reinvestment of all dividends, excluding 10-year NASDAQ return (N/A)
(c) 24 commercial banks comparable in size, geographic location, and lines of business to CBU.

BUSINESS SUMMARY

Community Banking

Community Bank, N.A. (CBNA), the second-largest community banking franchise headquartered in Upstate New York, has grown significantly in recent years. The number of households we serve (195,000) has more than doubled since 1996, and the number of branches we operate (116) has nearly tripled.

We have expanded by focusing on smaller towns and villages where competition is less concentrated and customer loyalty can be earned. In turn, we have leveraged our dominant market position to generate additional growth, giving us the largest or second-largest deposit market share in 66 of the 91 communities (73%) where we do business today.

Financial Services

We have focused on growing our financial services businesses since the mid-1990s. They reduce our dependence on net interest income and diversify our revenue sources, helping to mitigate the long-term impact of narrowing net interest margins – allowing for stronger, more consistent financial performance. In addition, two of our subsidiaries have brought us geographic diversification.

Our financial services income, at $13.7 million, is over four times the level we generated just six years ago. What's more, each of our 2001 acquisitions brought us thousands of new customers – a number of whom did not previously have access to such products from their prior banks. In the past year alone, many of them have become familiar with (and in many cases, purchasers of) our financial services products, as evidenced by our 8% growth in this area over 2001's revenues.

The various components of our financial services businesses performed as follows during 2002:

Benefit Plans Administrative Services, Inc. (BPA)

Our pension administrator and consultant subsidiary had a record year, growing revenues by 16% to $4.6 million. BPA now represents over 33% of our financial services income, and 15% of our total noninterest income. Based in Utica, N.Y., BPA serves the retirement plan administration and trust needs of more than 350 plan sponsors both within and outside of CBNA's markets, and services over $451 million in assets.

Elias Asset Management (EAM)

Acquired in April 2000, this investment advisory firm based in Williamsville, N.Y. contributed $2.7 million to 2002 revenues. EAM has approximately $405 million in assets under management, from more than 900 clients. Led by President and Chief Investment Officer David J. Elias, EAM made up 9% of our total 2002 noninterest income, and 19% of our financial services income, despite a very challenging economy.

David has appeared on "Wall Street Week" with Louis Rukeyser and is a frequent guest on CNBC and CNN. He is a contributing editor to *Chief Executive* magazine, a member of the national board of governors of the Money Management Institute in Washington, D.C., and an author of two investment advice books.

Financial Services Growth in millions

2002	$13.7
2001	$12.7
2000	$10.8
1999	$6.5
1998*	$5.9

5-year CAGR 22.4%

* 1998 and 1997 base period estimated to include 2001 acquisition of First Liberty Bank Corp. (FLIB); all other figures are restated actuals, including FLIB.

Loan Growth in billions

2002	$1.8
2001	$1.7
2000	$1.5
1999	$1.4
1998	$1.3

5-year CAGR 8.5%

Community Investment Services, Inc. (CISI)

CISI's mutual fund and related financial product sales also had a record year, adding $3.7 million to 2002 revenues. This comprised 12% of our total noninterest income for the year and an increasing source of profit, soundly supporting our 1999 decision to eliminate third-party broker-dealers from our distribution process and create our own in-house capability. CISI revenues grew 57% in 2002 due largely to our in-branch referral program and strong annuity sales, coupled with the hiring of additional financial consultants. Assets held by CISI customers now approximate $230 million.

Personal Trust

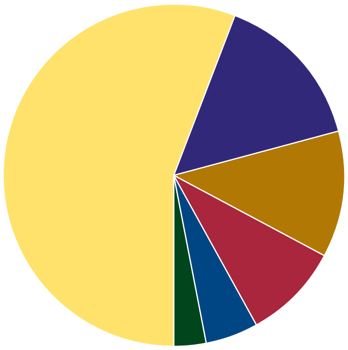
We have offered a full range of personal trust services for many years, including living, testamentary and charitable trusts, as well as estate settlement services, conservatorships and investment management services. Together, they contributed $1.7 million (more than 5%) of our total noninterest income in 2002. Personal trust assets under management now exceed $277 million.

Insurance Products Sold Through CISI and at CBNA Branches

In 1999, we expanded the product capabilities of our financial consultants by adding long-term health care and other selected insurance products to their offerings. This, along with greater sales of creditor life and disability insurance at CBNA branches and the related annual dividend from the underwriting agency, resulted in revenues climbing to nearly $1.1 million in 2002, up more than 48% from 1999's levels.

Deposit Accounts

CBNA's deposit account services include standard checking, interest checking, money market, savings, time deposit and individual retirement accounts (IRAs). Individuals, partnerships, and corporations (IPC) comprise approximately 78% of our depositor base, with deposits from municipalities within our market areas making up the balance. We also offer a complete suite of electronic tools to our depositors, including Internet and telephone banking, bill payment, ACH (Automated Clearing House) direct deposit, and a variety of cash management sweep products.



CBNA's total deposits decreased slightly over 2001's level (down 1.6%) after soaring by nearly 75% last year as a result of our three acquisitions (31% growth when 2000 is restated for First Liberty). Also in 2001, we converted our Canton, N.Y. operations facility to a deposit-only processing center, which lowered our unit processing costs in 2002, and now handles all deposits across the franchise more efficiently.

Lending

In the last several years, CBNA has placed a predominant focus on the commercial borrower in order to further diversify its loan portfolio. However, the favorable interest rate environment of 2002 resulted in unusually high levels of consumer mortgage and indirect lending, increasing total loans to a record $1.8 billion. And like our Canton deposit facility, we also converted our Olean, N.Y. operations facility to a single-purpose center in 2001, to better process loans franchise-wide.

About 65% of our outstanding loans are provided to consumers borrowing on an installment and residential mortgage loan basis. Commercial loans are typically for amounts under $100,000. Despite a slight dip in commercial lending in 2002, we've actually grown our business loan portfolio by 119% over the last five years (earlier years exclude First Liberty). It currently comprises 35% of total loans.

Our lending activities include residential, installment, student and farm loans, business lines of credit, working capital facilities, special purpose term lending, equipment leasing services (through a third party), and inventory and dealer floor plans.

DOUBLE A VINEYARDS

In 1990 Dennis and Sue Rak formed Double A Vineyards, a grape vineyard and nursery outside Fredonia, N.Y. that serves the winery and grape juice markets. They began modestly, but soon reached a point where they were ready to expand and grow their business significantly. However, the super-regional bank which had approved their original loan would not help them take their next steps, claiming they were attempting to grow too quickly.

"We're a little different from many businesses," says Sue. "It takes some time to understand our industry, and our old bank wasn't willing to take that time."

But Community Bank System was, and in 1997 Dennis and Sue began a relationship with us that would give Double A Vineyards the funding it needed to become what it is today: the largest grape vine nursery east of California!

Double A Vineyards has grown its revenues from $895,000 in 1997 to over $1.9 million in 2002, adding 60 acres and 1.5 million vine cuttings during that span. They currently cultivate over 85 varieties of grapes with such a superior quality that Dennis was given the 2002 "Grower Award" by the New York State Wine & Grape Foundation. Most impressively, Double A Vineyards is the main supplier of grape vine plantings to the garden centers of The Home Depot, Lowe's and Wal-Mart.

ALCAS CORPORATION

Encompassing four successful subsidiaries – CUTCO Cutlery, Vector Marketing, CUTCO International and KA-BAR – Alcas Corporation has been on a path of steady growth over the last two decades, stemming from the sales of its products through the direct-selling efforts of its Vector Marketing sales force. In 2002, the Olean, N.Y.-based company achieved $250 million in sales, a 20% increase over 2001.

Its famous brand of CUTCO knives has been an element in kitchens throughout North America since 1949, and its KA-BAR brand of sporting knives is quickly becoming commonplace among outdoorsmen and recreationers everywhere. Currently Alcas ranks as the fifth-largest, privately held company in all of Western New York (which includes the Buffalo-Niagara region).

Community Bank System's involvement with Alcas dates back to 1989 and the $1.8 million loan it granted to help the company expand its headquarters. CBU remains today among the company's primary lenders as Alcas makes its way to its goal of being a $500-million company by the end of 2007.

Before You Build, You Need a Blueprint

Community Bank System (NYSE: CBU) has been a solid, consistent performer throughout the last decade, steadily growing through a variety of means. And as simple as it sounds, our success has been attributable to two things: our unwavering commitment to the plan for growth we created in 1993, and the unique way we service our customers.

Therefore, we felt that this year's annual report should give you a better understanding of both.

In the following pages, you will learn about our four-step growth plan: how each component has contributed to our past success and will continue to provide additional opportunities for us in the near- and long-term. And you'll also meet some of our very best success stories: customers throughout our markets who have truly succeeded either in their business or personal lives – with our help, service and steady support.

We have achieved a great deal of success in recent years by developing and remaining committed to an operating strategy that consists of four key elements:

1. Create a dominant branch system with decentralized decision-making at the branch level.
2. Diversify our revenue and earnings streams through noninterest income.
3. Build profitable loan volume.
4. Utilize technology to enhance customer service and productivity.

There it is – the "secret" to our success. Four simple guidelines. Tactics, really, that allowed us to double the size of our company from 1994-1997, and double it again between 1997-2001. But it's not that simple, obviously, or anyone could do it. And we've seen time and again that many cannot – especially the super-regional banks, who abandoned our markets throughout the 1990s after realizing that their business models did not work as well as our own does in our regions. So it's worth taking a closer look at each element, and its importance to CBU's growth.

Growth Element 1: Making Ourselves "At Home"

CBU has intentionally gone down "the road less traveled" in our franchise strategy, focusing on smaller cities, towns and villages – markets where competition is less intense and customer loyalty can be obtained through trust, outstanding service and a commitment to supporting the communities where we live. To that end, we empower our associates at the local level to be key decision-makers, resulting in faster, more responsive service to our customers, without sacrificing accuracy or compromising our credit guidelines and standards.

And why shouldn't our employees be so empowered? After all, they often know our customers best. You see, in "Small Town, U.S.A.," neighbors tend to look out for one another. Our lenders see our customers at the local hair salon, the grocery store or their kids' high school basketball game. They can gauge qualities within our customers and intangibles to their situations that far exceed the details any financial application could provide. True to our name, they literally make Community Bank part of the community. So who better to help their neighbors make appropriate financing decisions?

NORTHEASTERN PA MCDONALD'S

In 1972, Albert and Carol Mueller moved to Scranton, Pa. to open a McDonald's restaurant. Having previously owned and operated a successful bakery and coffee shop in suburban Chicago, this husband and wife had all the credentials to indicate their success in this endeavor too.

In fact, their first restaurant was virtually an instant success. Soon they were ready to expand, and began developing relationships with various regional banks. Surprisingly, however, they were not treated like the experienced, proven entrepreneurs that they were.

"None of the other banks really impressed us," says Carol. "But then our attorney introduced us to Leo Moscowitz of (a predecessor of) First Liberty Bank. He was wonderful – a banker who truly understood the uniqueness of small business ventures. More importantly, he really believed in our venture and thought the world of my husband, who prides himself on his business ethics. The two of them formed a very strong bond."

Twenty-five years later, though Leo has retired, his approach to building customer relationships is still ingrained in the First Liberty family – which is why The Muellers are still a part of our family too, now with 14 McDonald's locations across Northeastern Pa. Best of all, the Muellers are the kind of customer every bank covets: the kind that gives back to their community. They were the catalysts behind two Ronald McDonald Houses in the Scranton/Wilkes-Barre region, as well as the area's Ronald McDonald's Children's Charity Organization, which supports child wellness and development.

With this line of thinking, we've established a dominant presence in these markets, ranking first or second in deposit market share in about three-quarters of the towns where we do business. And we are striving to obtain a larger share of the market in our other locations as well.

Growing by (Disciplined) Leaps and Bounds

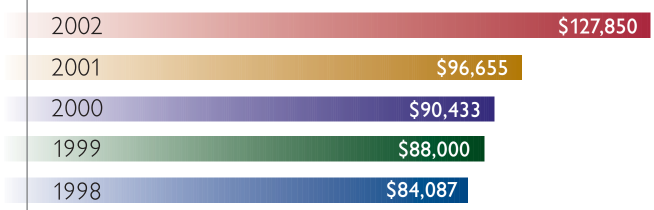
One important way we've become such a strong player is through a disciplined acquisition strategy. In fact, in the last nine years we've made eight branch or whole-bank acquisitions, adding 93 branches to our network (a number have since been combined to improve our efficiency and customer service). We've expanded our footprint throughout Central, Northern and Western New York, and recently expanded into the Northeast Pennsylvania market as well – all through our ability to identify, evaluate, execute and fully integrate acquisitions. How? CBU benefits from its nine-member management team who together contribute over 250 years of banking experience. This experience is a tremendous difference-maker when it comes to acquisition skills and savvy.

And while experience is critical in any company's success, it never hurts to have a personal interest at stake as well. Our Board and Executive Management Team together own nearly 12% of the company, ensuring each member's persistent focus toward the company's continued success.

More to Come?

Our acquisitions have all been sound contributors to our growing and profitable network, and given the expertise we've established in this area, we see no reason to back away from something that has worked so well. In late 2001 we completed a secondary common stock offering of more than 1.3 million shares, in addition to placing nearly $50 million in floating-rate trust preferred securities. Besides reducing our short-term debt levels, both provided significant additional capital to support earning asset growth in our newly-acquired FleetBoston branch markets. These offerings followed on a $30 million fixed-rate trust preferred financing in early 1997, which helped fund our combined 20-branch acquisition from Key and Fleet later that year. Prior to that was an 863,000-share common stock and $9 million preferred stock financing in mid-1995, which supported the purchase of 15 branches from the former Chase Manhattan Bank. We are pleased with the success we have had in attracting new investment when our growth plan requires it, as well as our ability to quickly absorb any initial earnings dilution that our strategy may entail.

Net Interest Income in thousands



5-year CAGR 9.1%

Growth Element 2: Noninterest Income – CBU's Alternative Fuel

The second component of our growth strategy is to diversify our revenue stream through a greater focus on noninterest income. In the mid-1990s we pledged to increase this less cyclical revenue source, which helps mitigate compression on our net interest margins (that's the yield on our loans and investments less cost of funds), thereby making CBU less susceptible to earnings volatility. We subsequently obtained the products and know-how that our customers need and will buy, an investment that has clearly paid off. In 1996, our noninterest income was just $8.9 million, but by the end of 2002 it was over 250% higher at $30.9 million – in just six years' time.

Perhaps more importantly, noninterest income comprised only 13.6% of our total revenue in 1996, but today it comprises nearly 18%, despite the significant growth recently in our net interest income as a result of 2001's acquisitions.

We see financial services as the largest and most promising area within our noninterest income portfolio. The 1999 Financial Services Modernization Act clarified the financial products and services that community banks could offer, thereby "leveling the playing field" for banks to better compete with other financial services providers. Our complement of financial services products is now robust, including those offered through:

- Our broker-dealer (which provides mutual funds and insurance products through CBNA branches and independent offices);

> "The other bank didn't even know the location we were considering, even though it was less than an hour away."

Tracy & Michael Hurilla

THE EDGE HOTEL

Tracy and Michael Hurilla recognized the potential for a hotel in Lewis County (N.Y.). Each year thousands of tourists come to the region's Adirondack Mountains to kayak, fish and golf in the warmer months, or snowmobile and ski when the snow flies. So the Hurillas developed a plan to build their hotel, and were as excited as could be with its potential.

That excitement was quickly squelched, however, when the big, super-regional bank they approached for financing turned them down – despite having been solid customers for 15 years! Then they approached a second bank. "The other bank didn't even know the location we were considering," says Tracy, "even though it was less than an hour away."

But Community Bank did. And we knew the Hurillas too, because Adam Smykla (our lending officer) was involved in his community's chamber of commerce, which made him very familiar with Michael's successful construction company. Adam also knew the proposed site, and agreed that a hotel would likely do very well there. "Most of all," says Tracy, "he took the time to really understand our plan." So on his recommendation, Community Bank agreed to help.

Today, The Edge Hotel features 51 rooms, all of which have been steadily occupied since their doors opened in February 2002. In addition to possibly adding more rooms, the Hurillas are considering adding a conference room, banquet facility or even an adjacent shopping plaza in the near future.

UBS-PAINEWEBBER

Benefit Plans Administrative Services, Inc. (BPA) provides actuarial, daily valuation recordkeeping and custodial services to organizations that offer retirement plans to their employees. BPA markets these services to mutual fund companies, other banks and broker-dealers, who in turn sell full-service retirement plans to their end-user customers.

Over the past four years, BPA's customer base has grown dramatically to include clients in 27 states and the Commonwealth of Puerto Rico. Client companies include GE, Marriott, Oracle, McDonald's and NFA Burger King. UBS PaineWebber Trust is a significant source of business for BPA in Puerto Rico. U.S. distributors include American Funds, Federated Investors and numerous other banks, trust companies and investment advisors.

How does a retirement plan administration firm located in Utica, N.Y. develop relationships with client companies and distributors of this stature? According to Barry S. Kublin, BPA President, "Our location provides us with an enviable cost structure, our ownership structure provides us with the necessary capital to compete technologically, and our business focus of administering complex retirement plans provides us with a broad geographic market of plans that larger administration firms choose not to support. Much like the approach our sister company, Community Bank System, takes toward its banking customers, BPA is large enough to offer high-tech services, yet small enough to deliver those services in a high-touch manner."

- Our personal trust department (which offers investment services in addition to estate planning and settlement services);
- Our benefit plans subsidiary (which provides actuarial and daily valuation recordkeeping services to sponsors of retirement plans in 27 states and the Commonwealth of Puerto Rico); and
- Our asset management subsidiary (which provides wealth management services to high-net-worth individuals, corporations and not-for-profits, a number of whom reside in parts of New England, Pennsylvania, the Midwest and Florida, besides New York State).

Financial services revenues now comprise 44% of our total noninterest income, up from 36% in 1996. This number was actually higher in 2001 at 48%, and would have risen this year, were it not for the welcomed surge in noninterest banking revenues from the FleetBoston branch acquisition, as well as expanded overdraft and electronic banking income from the remainder of the bank. Nonetheless, the total dollar amount contributed by financial services rose 8%, year-over-year, to $13.7 million. Clearly this business is still performing well, and will be among our first and most significant areas to benefit from a rebound in the economy.

Getting More from our Mergers

One of the biggest contributions our financial services products make is the impact they have on our acquisitions. For example, when we first considered buying First Liberty Bank & Trust in 2001, we recognized that in addition to its fundamentally solid organization, impressive asset quality and cost saving opportunities, it was also potentially a significant new outlet for all of our financial services products. First Liberty had barely begun offering a select few of these products. Therefore, we saw that we would be inheriting a customer base that was lacking – and needed – these very products and services. Just one year later, we have already seen strong customer

Noninterest Income excl. securities/debt extinguishment gains/losses

2002
2001
2000
1999
1998

5-year CAGR 17.1%

> "We couldn't have made it through this without Diane's help. She helped us tremendously during a really difficult time."

Rachel and Jeremy Newvine

HOMEOWNERS

Rachel and Jeremy Newvine were like any young newlyweds. Married in their late 20s, this St. Lawrence County (N.Y.) couple both got jobs and began planning the next steps of their lives together.

But then something happened that they had not planned for at all. Though just 27, Jeremy was diagnosed with cancer, which quickly halted many of their plans. But one plan they did not want to give up was their dream to own their own home.

However, Jeremy's illness forced him to disability status with his employer just as they were ready to apply for their mortgage. With Jeremy as the major source of income in the family, this would have been a crushing blow to their credit profile with many banks. Lucky for the Newvines, however, they had applied through their local Community Bank, N.A. branch. There they met Diane Easton, their lender who was determined to help them find a way to make this happen. Working in conjunction with the St. Lawrence County Housing Council, Diane was able to put together a creative and feasible plan that allowed them to be approved.

"We couldn't have made it through this without Diane's help," says Rachel. "She just made everything so easy for us. She helped us tremendously during a really difficult time."

Best of all, this story has a happy ending. Not only did their dream to own a home come true, but Jeremy's cancer is in remission and he's back working full-time.

demand in this market for our financial services, along with a similarly positive response in the markets serviced by the FleetBoston branches acquired later in 2001.

Growth Element 3: Come Borrow From Us!

Our growth strategy's third component is our commitment to build a profitable and diversified loan portfolio. We've been particularly strong in this area, growing our total loan portfolio at a 16.5% reported compound annual rate over the last five years to its current $1.8 billion level. This was achieved through a combination of organic growth, loans that came with our bank and branch acquisitions, and subsequent growth in the acquired new markets. Better yet, we've done this while maintaining asset quality levels that are equal to or better than those of our 24-bank peer group.

Prior to 2002, we were actually growing commercial loans faster than loans to individuals – a conscious effort on our part to reposition our lending approach and focus in order to achieve a more balanced portfolio.

However, 2002's unusually low interest rate environment brought an unprecedented surge in activity among retail borrowers who sought to take advantage of the resulting favorable housing market and refinancing opportunities. Consequently, in 2002 our consumer mortgage portfolio grew by 15% ($67 million) over 2001's levels, and now represents 28% of total loans outstanding.

Similarly, consumer indirect loans (borrowing originated mostly on site at automobile dealerships) also benefited tremendously from this favorable interest rate environment and our attractive financing programs. We saw strong growth in both our New York and Pennsylvania markets in 2002, each of which added new originating dealers during the year. Indirect loans rose $39 million or 16% during 2002, ending the year at $287 million.

CORNING NATURAL GAS

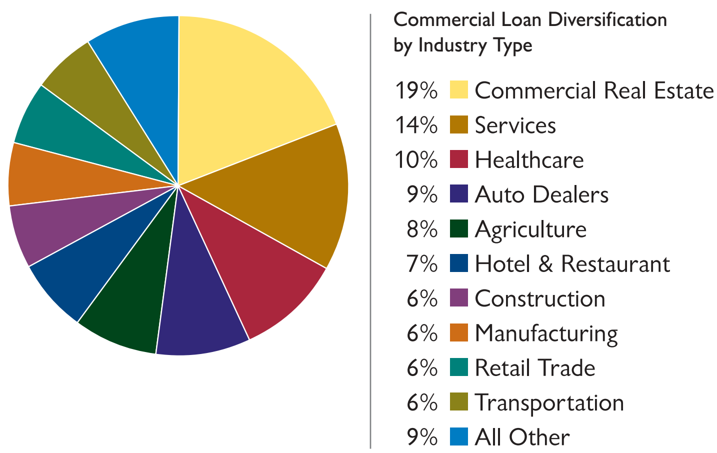
Corning Natural Gas (CNG) has relied on Community Bank System for ten years for a true variety of financing needs. Not only have we helped CNG finance its natural gas local distribution company (which serves New York's Finger Lakes and Southern Tier regions), it also contains several other diversifying segments, including its:

- Appliance division, which sells, rents and services gas-burning appliances;
- "Tax Center" division, which provides tax preparation, accounting and payroll services to approximately 1,000 clients;
- Realty division, a residential and commercial real estate business with more than 60 agents in and around Corning; and its
- "Foodmart Plaza" retail complex, an eight-tenant leasing business anchored by a major supermarket.

Community Bank has assisted with the financing for all of these CNG subsidiaries, and has helped this company grow to the nearly $29 million-asset entity it is today.

Though we are more than happy to "go with the flow" and enjoy the benefits of the current environment, we are still convinced of the long-term merits of our lending strategy, and remain focused on growing our commercial portfolio. We've hired skilled, experienced commercial lending professionals, many of whom left the super-regional banks within our markets to join Community Bank System. By empowering them to make loan decisions locally, we ensure a greater degree of control over asset quality and accuracy, engender higher customer satisfaction, and foster a deeper sense of employee motivation. Many of our lenders longed for such responsibilities during their tenures with the super-regionals, an autonomy that positions us extremely well to compete for good quality loan business. Though business lending has remained essentially flat in the Upstate

Commercial Loan Diversification by Industry Type



"Community Bank has been a great partner for our business. I've never experienced any other bank quite like them. It's their personal touch."

Dan Jordan

ADVANCED MONOLYTHIC CERAMICS

In 1994, Dan Jordan found himself working for a company that decided it wanted to exit the very niche business he knew best: specialty ceramic capacitor production. So instead of just watching another company develop a strength in this niche market, Dan decided he would create his own.

Dan approached Community Bank with his idea and a business plan for success. Though he had no prior experience owning and running a business, Dan's plan was strong, so the bank approved his financing request.

Today Dan's company, Advanced Monolythic Ceramics (AMC), is a leading specialty ceramic capacitor manufacturer that primarily serves the aerospace and military industries.

AMC has grown steadily since 1994, most recently completing a major acquisition (also with the assistance of CBNA). When coupled with the relocation and expansion of its headquarters in Olean, N.Y., Dan has brought over 150 new jobs to New York's Southern Tier, which led Governor George E. Pataki to name Dan Jordan as New York State's Small Businessman of the Year in 2001.

"Community Bank has been a great partner for our business," Dan says. "I've never experienced any other bank quite like them. It's their personal touch. Whenever I have to talk to them, I just pick up the phone and there they are. Better yet, they'll be on my front doorstep in a half hour, if I need them."

New York and Pennsylvania markets during this challenging business environment, we anticipate this will improve as the economy stabilizes and strengthens.

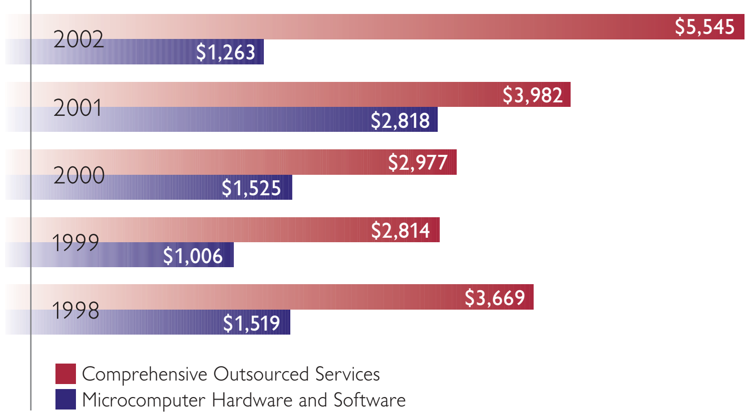
Growth Element 4:
Technology – Building The Perfect Service Mix

The fourth element of our growth strategy sometimes surprises those who tend to think of community banking as it was thirty years ago. But just as we hope you've seen from our customer examples in this report, here's yet another area where you might be pleasantly surprised.

Our fourth focus is technology – specifically, an on-going commitment to have the necessary technology in place to support both our growth and cost-reduction initiatives. In fact, we have made significant investments in technology over the years as well as recently, such as:

- Working with a technology partner, to ensure that our systems remain up-to-date and responsive to all our business needs. Ten years ago, we established a contractual relationship with Fiserv, the largest data processing provider to the banking industry, having developed deep expertise over many years. We believe our alliance with Fiserv has provided the most economical and effective solutions available to meet our technology needs, enabling us to more quickly offer expanded products and services to customers.
- Successfully introducing Internet banking to CBU customers. Internet banking has been widely accepted by more than 18,000 commercial and residential customers. We have also offered on-line capabilities for nearly four years now to the 401(k) accounts serviced by our Benefit Plans Administrative Services subsidiary. And we continue to enhance back-office support services to our brokerage customers through automation.
- Converting our check processing to an image-based system to improve our operating efficiency. We are currently in the planning stage with Fiserv to develop a means by which customers may have their statements delivered to them via the Internet (e-statements). This capability complements our check safekeeping services – used by over 46% of our customers.

Investment in Technology in thousands



- Promoting our telephone banking service (actively used by 29,000 customers) and our extensive network of 85 ATMs, both of which have provided enhanced convenience for our customers – and improved efficiency for us.

All told, in the last five years we have invested over $27 million in technology-related issues, be they microcomputer hardware and software purchases or our comprehensive outsourced services. We expect to invest another $3.5 million in computer hardware and software in 2003, as we continue to refine the perfect mix of convenience and personal touch for our customers.

What Goes Around...

Like we said at the start of this "Strategic Growth Blueprint," the secret of our success is "simple." We do two things: we stick to our plan, and we provide the best customer service around. And while you've just seen that it's a bit more complicated than this, these two objectives really are the essence of Community Bank System.

We hope this review of our growth strategy, coupled with our various customer accolades, has helped you better understand our company and our plan for achieving better and better results. 2002 was a great success for our company, but by no means are we ready to rest. We remain as confident as ever that our plan will allow us to continue building on *your* success. That's why we're here… to help you – our customers and our investors – to succeed. If we keep doing that, the rest will take care of itself.

BOARD OF DIRECTORS

James A. Gabriel was named Chairman of the Board on January 1, 1999. At age 55, he has served as a Director of the company since 1984. He is Owner of the law firm of Franklin & Gabriel, located in Ovid, New York.

Sanford A. Belden, age 60, has served as a Director of the company since 1992, when he was also named to the posts of President and Chief Executive Officer. Mr. Belden was formerly Manager, Eastern Region, Rabobank Nederland, New York, New York from 1990 to 1992 and prior thereto served as President, Community Banking, for First Bank System, Minneapolis, Minnesota, a multi-state bank holding company.

John M. Burgess has served as a Director of the company since 1991. At age 66, he is a retired president of Kinney Drugs, Inc., a drug and retail chain with stores primarily located throughout Upstate New York. He is Chairman of the Investment and Technology Committees, and a member of the Audit/Compliance/Risk Management and Loan Committees.

Paul M. Cantwell, Jr., age 61, is the former Chairman and President of the Citizens National Bank of Malone, which was acquired by the company in January 2001, at which time he became a Director. He is Owner of the Cantwell & Cantwell Law Offices located in Malone, New York. He is a member of the Personnel and Trust Committees.

William M. Dempsey is retired from the Rochester (NY) Institute of Technology (RIT), where he was VP, Finance and Administration, and President of the American College of Management and Technology (an affiliate of RIT), located in Dubrovnik, Croatia. He is Chairman of the Nominating and Audit/Compliance/Risk Management Committees and a member of the Investment and Technology Committees. At age 64, he has been a Director since 1984.

Nicholas A. DiCerbo is a Partner of the law firm of DiCerbo & Palumbo of Olean, New York. At age 56, he has been a Director of the company since 1984. He is Chairman of the Strategic/ Executive Committee and a member of the Loan and Personnel Committees.

Market Capitalization in thousands*

2002
2001
2000
1999
1998

*CBU capitalization only

Dividends per Share annually

2002
2001
2000
1999
1998

CORPORATE OFFICERS

Sanford A. Belden
Mr. Belden has been President and Chief Executive Officer of the company and the bank since October 1, 1992. Mr. Belden was formerly Manager, Eastern Region, Rabobank Nederland, New York, New York from 1990 to 1992 and prior thereto served as President, Community Banking, for First Bank System, Minneapolis, Minnesota, a multi-state bank holding company.

David G. Wallace
Mr. Wallace became Vice President and Chief Financial Officer of the bank and Treasurer of the company in November 1988 and Senior Vice President and Chief Financial Officer of the bank in August 1991. He assumed his current position in February 2000. He was formerly Executive Vice President, Cates Consulting Analysts, Inc. from 1987-1988, and previously held senior financial planning and analysis positions at Syracuse Savings Bank and Maryland National Bank. He intends to retire during the second quarter of 2003.

Lee T. Hirschey, age 67, has been a Director of the company since 1991. He currently serves as President and Chief Executive Officer of Climax Manufacturing Company, a converter and manufacturer of paper products headquartered in Castorland, New York. He is Chairman of the Trust Committee and a member of the Investment, Nominating, and Personnel Committees.

Harold S. Kaplan, has served as a Director of the company since 2001, following the merger of First Liberty Bank & Trust Co. Mr. Kaplan, Co-owner M.C.F., Inc. and Partner, D&T Real Estate, Scranton, Pennsylvania, is 69 years of age. He serves on the Investment and Trust Committees of Community Bank.

Saul Kaplan, age 77, is a former President of NBO National Bank which merged into First National Bank of Jermyn in February 1999, and merged subsequently into First Liberty Bank & Trust. Mr. Kaplan has served as a Director of the company since 2001, following the acquisition of First Liberty Bank & Trust. He is Co-owner M.C.F., Inc. and Partner, D&T Real Estate, Scranton, Pennsylvania.

David C. Patterson is President and owner of Wight and Patterson, Inc., a manufacturer and seller of livestock feed located in Canton, New York. At age 61, he has served as a Director of the company since 1991. He is Chairman of the Loan Committee and a member of the Nominating, Strategic/Executive, and Trust Committees.

Peter A Sabia, owner of Valley Dodge Truck Center, Dunmore, PA, is 71 years of age. He has served as a Director of the company since 2001, following the merger of First Liberty Bank & Trust. Mr. Sabia is a member of the Compensation, Loan, Technology and Trust Committees.

William N. Sloan, age 68, has served as a Director of the company since 1991. He is Vice President for Administration Emeritus with The State University of New York College at Potsdam, where he also served as Associate Professor of Mathematics prior to 1997. He is Chairman of the Personnel Committee and a member of the Audit/Compliance/Risk Management, Strategic/Executive, and Technology Committees.

Corporate Officers, left to right: Michael A. Patton, James A. Wears, Sanford A. Belden, David G. Wallace, Steven R. Tokach

Michael A. Patton
Mr. Patton was named President, Financial Services in February 2000. He was formerly the President and Chief Executive Officer of The Exchange National Bank, a former subsidiary of the company, from 1984 until January 1992, when, in connection with the consolidation of the company's five subsidiary banks into Community Bank, N.A., he was named President, Southern Region.

James A. Wears
Mr. Wears was named President, Banking in February 2000. Formerly he served as Senior Vice President of the St. Lawrence National Bank, a former subsidiary of the company, from 1988 through January 1991 and as President and Chief Executive Officer from January 1991 until January 1992. Following the January 1992 consolidation of the company's five subsidiary banks into Community Bank, N.A., Mr. Wears was named President, Northern Region.

Steven R. Tokach
Mr. Tokach assumed his current position of President, First Liberty Bank & Trust in May 2001, when First Liberty Bank Corp. was purchased by Community Bank System, Inc. He was Executive Vice President of First Liberty Bank Corp. and First Liberty Bank & Trust from 1994-2001, and from 1998-1993, served as Vice President and Executive Vice President of Guaranty Bank, N.A. and First Eastern Bank, respectively, both in Pennsylvania.

The following terms are particular to our industry and appear throughout this Annual Report. A more detailed explanation of certain terms is found in the Notes to the company's financial statements contained on Form 10-K within this Annual Report.

Acquisition-related items: One-time expenses related to consummating and integrating the company's acquisitions, including associated investment and debt restructuring.

Net income – operating: Net income, excluding acquisition-related items and unusual expenses.

Cash earnings (net income – cash): Net income, excluding the after-tax impact of amortizing (writing down over time) the premium that the company has paid for its acquisitions. Many analysts consider this as a better measure of a company's earnings power and ability to support future growth.

Cash operating earnings (net income – cash operating): Increases cash earnings by the after-tax impact of acquisition-related items and unusual expenses.

Consumer direct lending: Direct lending to consumers through the bank's branches, largely on an installment basis, for the purchase of automobiles and durable (long lasting) goods for the home, and for educational and general purposes. Also includes loans secured by the equity in a borrower's home.

Consumer indirect lending: Loans originated through applications taken on the premises of automobile, boat, and other dealers selling substantially priced goods, electronically submitted to the bank, and approved within a very short time period while the consumer remains on premises.

Core deposits: The total of checking, interest checking, savings and money market deposits, and certificates of deposit less than $100,000. Generally considered a bank's most stable and affordable source of funds.

Coverage ratio: The ratio of loan loss allowance to nonperforming loans (loans for which payment is delinquent 90 days or more and loans for which interest is not being accrued) or nonperforming assets (additionally includes collateral acquired by a bank after a loan has defaulted). Considered an indicator of the strength of a financial institution's allowance for loan losses.

Diluted shares (or fully diluted): A calculation which includes those shares issued and outstanding or issuable upon the exercise of in-the-money stock options held by employees or Directors, offset by the number of shares which the company could repurchase on the open market with the cash received upon exercise. Shares held in treasury are excluded.

Efficiency Ratio (Recurring): Measure of a bank's productivity, derived by dividing overhead expense by revenues (net interest income (FTE) plus noninterest income), excluding the effect of gains or losses on the sale of securities or the extinguishment of debt, amortization of intangibles, gains or losses on the sale of subsidiaries, disposition of branch properties, acquisition-related expenses and other one-time items. The lower the ratio, the better the efficiency.

Full-tax equivalent (FTE): Restatement of tax-exempt interest income as if it were fully taxable. Enables tax-exempt interest income to be compared to taxable interest income on a consistent basis.

IPC deposits: Deposits from individuals, partnerships and corporations (i.e., all consumer and commercial deposits). Excludes deposits from local governments/municipalities. Constitutes the major component of core deposits (see above).

Interest rate spread: The difference between the yield on a bank's earning assets and the rate it pays on its combined interest-bearing funds (deposits plus borrowings). It's considered a basic measure of sensitivity of a bank's net interest earnings to changes in interest rates, excluding funding from noninterest-bearing sources.

Loan loss provision: The charge against earnings to increase the allowance for loan losses (net of current period charge-offs) sufficient to absorb probable future charge-offs.

Net interest income: Banking revenues generated from standard lending and investment activities, equaling the difference between interest income on loans and investments and interest expense on deposits and borrowings. It's the primary source of earnings before expenses for most banks.

Net interest margin: A performance measure or ratio which is calculated by dividing net interest income by average interest-earning assets. It's the most basic indicator of the relative return on loan and investing activities before overhead and loan loss provision. Interest rate spread is a component of the net interest margin.

Noninterest income: Revenues generated from fee-based depositor and borrowing services (including ATMs and overdrafts), and the sale of financial services products. As reported by the company, it may exclude gains or losses from the sale of securities and extinguishment of debt and the impact of the disposal of branch properties, if indicated.

Nonperforming assets: Represent loans delinquent as to interest or principal for a period of 90 days or more, loans for which interest is not being accrued (no payments expected), restructured loans, and real estate acquired through foreclosure.

Tangible equity/assets: Shareholders' equity net of goodwill and intangible assets divided by the assets of the bank, net of goodwill and intangible assets. It's a highly conservative measure of capital strength which assumes that premiums paid for the franchise value of acquisitions have no value.

Tier 1 Capital: Shareholders' equity, adjusted for the unrealized gain or loss on securities held for sale and for certain assets such as goodwill and other intangibles. It's the primary measure of a bank's capital as defined by various bank regulatory agencies.

2002 was a great success for
Community Bank System, but by
no means are we ready to rest.
We remain as confident as ever that
our growth strategy will allow us
to continue building on *your* success.
We are here to help you – our
customers and investors – to succeed.
If we keep doing that, the rest
will take care of itself.

CBU LISTED NYSE

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