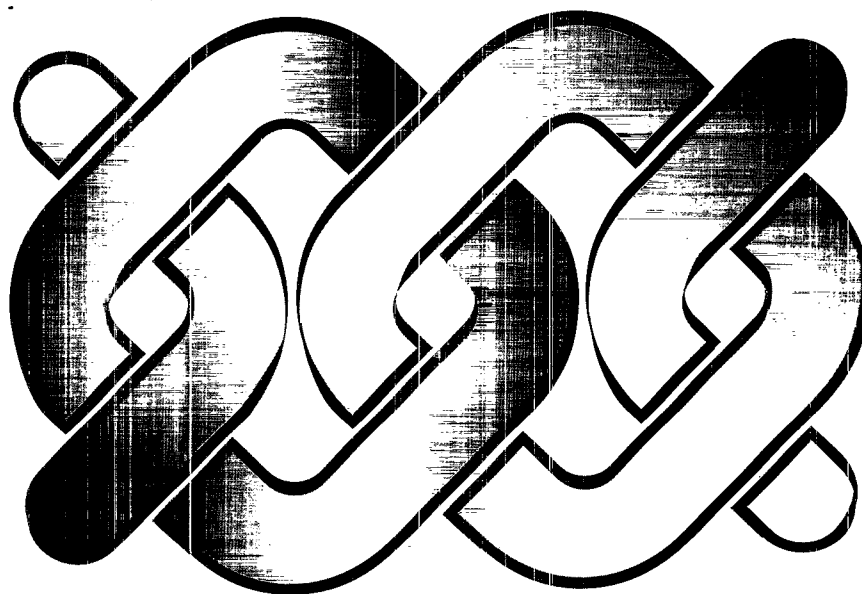


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COMMUNITY BANK SYSTEM, INC.  
ANNUAL REPORT



1998



*CBSI's mission is to be valued by its customers, employees, shareholders, and regulators as a well managed, profitable, independent bank committed to providing friendly, personalized, high quality financial services and products to the communities in which it operates.*



# COMMUNITY BANK SYSTEM, INC.

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## Consolidated Financial Highlights

	1998	1997	1996	Annual Change	
				1998/1997	1997/1996
<b>Total for Year (In thousands except per share)</b>					
Net income	\$ 15,728	\$ 15,562	\$ 14,133	1.1 %	10.1 %
Per share (diluted)	2.05	2.02	1.83	1.5	10.4
Cash dividends on common stock	6,472	5,737	5,117	12.8	12.1
Per common share	\$ 0.86	\$ 0.76	\$ 0.69	13.2	10.1
Weighted average number of common shares outstanding	7,671	7,676	7,482	(0.1) %	2.6 %
<b>Performance Ratios (In percentages)</b>					
Return on average assets	0.94 %	1.04 %	1.13 %	(0.10) % pts.	(0.09) % pts.
Return on average equity	13.01	14.09	13.88	(1.08)	0.21
Tier I capital / assets	5.71	5.67	5.89	0.04	(0.22)
Total capital / risk-weighted assets	10.49	10.55	11.83	(0.06)	(1.28)
Loan loss reserve / loans (net of unearned discount)	1.36	1.47	1.25	(0.11)	0.22
Nonperforming loans / loans (net of unearned discount)	0.43 %	0.49 %	0.44 %	(0.06) % pts.	0.05 % pts.
<b>Other Measures of Performance</b>					
Cash earnings per share (diluted)	\$ 2.41	\$ 2.30	\$ 2.05	4.8 %	12.2 %
(Earnings per share excluding after-tax impact of amortization of intangible assets)					
Tangible (cash) return on average equity	15.27 %	16.09 %	15.52 %	(.82) % pts.	.57 % pts.
(Return on average equity excluding after-tax impact of amortization of intangible assets)					
<b>At Year End (In thousands except per share)</b>					
Total assets	\$ 1,680,689	\$ 1,633,742	\$ 1,343,579	2.9 %	21.6 %
Loans, net of unearned discount	917,220	843,212	652,474	8.8	29.2
Investment portfolio and federal funds sold	593,540	611,892	578,584	(3.0)	5.8
Deposits	1,378,066	1,345,686	1,027,213	2.4	31.0
Shareholders' equity	120,166	118,012	109,352	1.8	7.9
Book value per share : Total	16.47	15.56	14.03	5.8	10.9
Tangible	\$ 9.01	\$ 7.82	\$ 9.85	15.2 %	(20.6) %



## President's Letter to Shareholders

### Dear Shareholders, Customers and Employees:

Our enduring commitment to improving value for shareholders continued apace during 1998 and will remain our overriding focus for 1999 and the ensuing years.

In August, we increased the anticipated annualized dividend by \$.12 per year or 15% to a total of \$.92. This dividend increase marked the seventh consecutive year of meaningful increases in dividend returns to shareholders. A combination of increasing dividend payouts and strong price appreciation has resulted in over 27% annual returns to shareholders during the five year period ended December 31, 1998. We are pleased to be able to reflect such consistent returns for shareholders.

To further enhance shareholder returns, we undertook a stock buyback during the second half of 1998. As of year end, a total of 326,600 shares had been repurchased, a significant step toward our announced maximum buyback target of 750,000 shares. The timing of the buyback was especially favorable, as it occurred during a period when cash flow from maturing and liquidated investment instruments could not profitably be reinvested in our investment portfolio. We will continue to evaluate the efficacy of continuing the buyback compared to utilizing our pool of capital in other, more beneficial ways.

The transition to having our common stock trade on the New York Stock Exchange from NASDAQ has more than met our expectations and those of our investors. Trading has been more efficient, price continuity has been enhanced, and the intraday volatility in our stock price has been reduced. Market depth and liquidity have both been enhanced, and our visibility in the investor community has improved.

Net income for the year reached another record level at \$15,728,000. While the absolute increase was just over 1%, earnings per share improved at a greater rate due to a reduction in the number of shares associated with the buyback. Tangible return on equity, which many analysts and investors consider a better measure of core profitability and value created for shareholders, reflected a level of 15.27% for the year, placing us near the top quartile among our regional peer banks based on data as of September 30, 1998.

Significant contributions to performance were made by the combined twenty branches acquired in mid-1997 from Key Bank in Southwestern New York (eight) and Fleet Bank in Northern New York (twelve). We have been very successful in building loan volume in these new locations through our locally based, responsive, decentralized decision making process, which continues to be very well received by customers in all our markets. The market share gains reflected in the Fleet acquisition have enhanced our returns in Northern New York, and projected branch consolidation opportunities in Boonville, Carthage, Gouverneur, Massena, Ogdensburg, and Watertown have been accomplished. Our new market presence in Chautauqua County made possible by the Key acquisition has already contributed importantly to earnings.

A de novo branch was opened in Jamestown, the largest town in Chautauqua County, on September 21. Along with its four other branches in the county, the Bank is leveraging on its strengths in mortgage, commercial, and agricultural lending. Initial activity has been promising. In addition, a new facility was opened on October 28 in Newark Plaza in Wayne County to replace a branch razed due to plaza expansion. These moves are evidence of Community Bank's strong commitment to helping its hometown communities grow.



It has been a persistent priority for several years to build our sources of noninterest income in order to reduce historical earnings dependence on net interest margin. We have been very successful in executing this priority as the contribution of recurring noninterest income has increased significantly to 18.4% of our operating revenues as of fourth quarter 1998. Most importantly, it has been driven by the creation of our Community Financial Services Group and the provision of additional products and services to our customers, enabling us to enhance customer relationships and deepen them through successful cross selling. We continue to build revenue nicely at Benefit Plans Administrative Services in conjunction with the employee benefits component of our trust business. Adding life insurance products to the investment product capabilities of our financial sales representatives has supported further growth in those revenues. We are especially pleased with the creation of our own broker/dealer subsidiary, expected to be implemented in March 1999, to replace the more expensive third party arrangement supporting our financial sales representatives.

Our commitment to customer service and building relationships has been supported as well in the mainstream of our banking business. Telephone banking utilization and customer use of our check card product and check safekeeping capabilities have increased consistently, helping to fuel improvement in operating efficiency. The addition in January 1999 of a commercial leasing product for our customers further enhances our offering of products and services for business customers.

The continuing strength and success of Community Bank derives from our differentiated style of providing responsive, localized decision making to our markets and customers. That strategy is executed with great effectiveness every day by our team of talented and dedicated employees. Our focus on sales and sales management training continues to yield dividends in improved customer service and cross sales success.

Our increasing ability to identify the particular needs of specific demographic customer segments and to deliver products and services against those needs, positions us well in a competitive financial services environment. The dedication and commitment of our employees to their communities and their customers is unsurpassed and is a continuing hallmark of Community Bank.

As noted a year ago, our Company is keenly aware of the challenges presented by Year 2000 business risk compliance. Our task force comprised of key personnel has worked successfully to define and coordinate the Year 2000 effort. We have adopted the five elements outlined by the banking regulators: awareness, assessment, renovation, validation, and implementation. We are satisfied with our progress against our well-defined plan.

My deep thanks again to the Board of Directors for effective and committed leadership. I especially want to recognize the contributions of Dr. Earl MacArthur, who retired as Chairman of the Board of Community Bank System, Inc. and Community Bank, N.A. at the end of 1998. Earl provided more than a quarter century of dedicated service to the Bank and his insight and counsel will be missed.

Sanford A. Belden, *President and Chief Executive Officer*

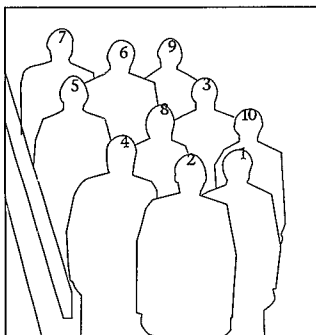


## Board of Directors and Corporate Officers



### **Community Bank System, Inc. and Community Bank, N.A. Board of Directors**

Dr. Earl W. MacArthur (1),  
Retiring Chairman (12/31/98)  
*Vice President, WMASC Educational  
Search Specialists, Morristown, New York*  
Sanford A. Belden (2)  
*President and Chief Executive Officer*  
John M. Burgess (3)  
*Retired*  
*Gouverneur, New York*



Richard C. Cummings (4)  
*Member, Cummings, McGuire,  
Dunkel and Campany, Attorneys at Law  
Lowville, New York*  
William M. Dempsey (5)  
*President/Dean,  
American College of Management  
and Technology (RIT), Dubrovnik, Croatia*  
Nicholas A. DiCerbo (6)  
*Partner, DiCerbo and Palumbo  
Attorneys at Law, Olean, New York*  
James A. Gabriel (7),  
Chairman (1/1/99)  
*Owner, Franklin & Gabriel  
Attorneys at Law, Ovid, New York*  
Lee T. Hirschey (8)  
*President,  
Climax Manufacturing Company  
Castorland, New York*  
David C. Patterson (9)  
*President, Wight & Patterson, Inc.  
Canton, New York*  
William N. Sloan (10)  
*Vice President for Administration,  
Emeritus, State University of New York  
Potsdam, New York*



### **Community Bank, N.A. Management Committee (L - R)**

David G. Wallace  
*Senior Vice President  
and Chief Financial Officer, DeWitt*  
Sanford A. Belden  
*President  
and Chief Executive Officer, DeWitt*  
James A. Wears  
*Regional President, Canton*  
Michael A. Patton  
*Regional President, Olean*

### **Community Bank System, Inc. Corporate Officers**

Dr. Earl W. MacArthur, *Chairman*  
Sanford A. Belden, *President and  
Chief Executive Officer*  
David G. Wallace, *Treasurer*  
Charles M. Ertel, *Assistant Treasurer*  
Donna J. Drengel, *Secretary*  
W. Valen McDaniel, *Corporate Auditor*

### **Benefit Plans Administrative Services, Inc. (L - R)**

Barry S. Kublin,  
*Executive Vice President*  
Girard H. Mayer,  
*President and Chief Executive Officer*





## Marketplace

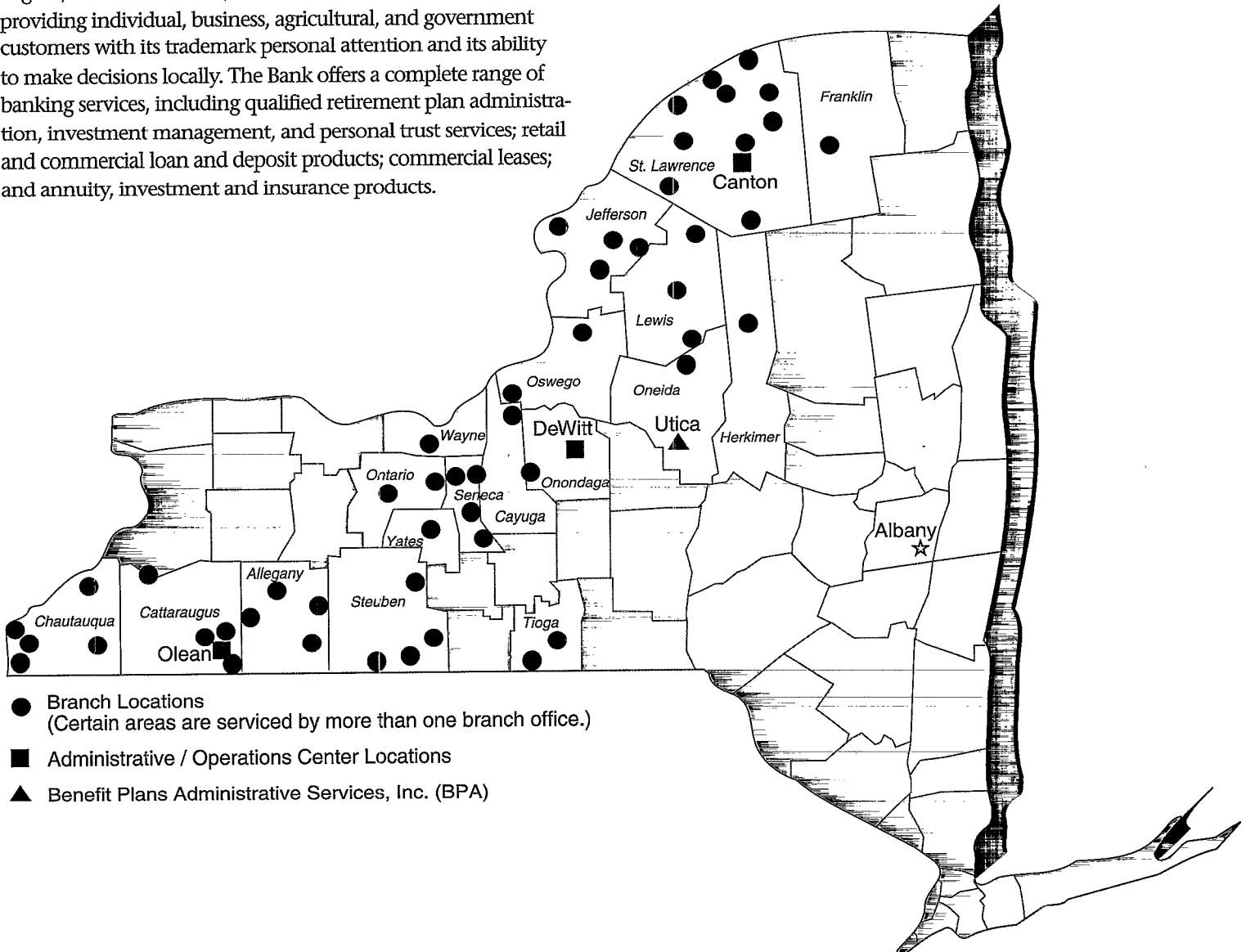
### COMMUNITY BANK SYSTEM, INC.

Community Bank System, Inc. (CBSI) was incorporated as a registered bank holding company in 1983 under Delaware General Corporation Law and maintains its principal office in DeWitt, New York, a suburb of Syracuse. The fifth largest commercial banking franchise headquartered in Upstate New York, CBSI operates a full-service, wholly-owned national banking subsidiary, Community Bank, N.A. (CBNA), with administrative offices in DeWitt, and regional headquarters in Canton and Olean.

The CBNA banking network comprises 68 customer facilities and 48 ATMs throughout Northern New York, the Finger Lakes Region, the Southern Tier, and Southwestern New York, providing individual, business, agricultural, and government customers with its trademark personal attention and its ability to make decisions locally. The Bank offers a complete range of banking services, including qualified retirement plan administration, investment management, and personal trust services; retail and commercial loan and deposit products; commercial leases; and annuity, investment and insurance products.

CBNA has a top three market position as measured by deposits in six of the eighteen counties where it operates, with market shares ranging from 24% to 40% based on deposits of all commercial banks, thrifts, and credit unions. These stronghold counties (Lewis, Seneca, St. Lawrence, Cattaraugus, Yates, and Allegany) constitute 60% of the Bank's deposits or the majority of its franchise. On a local market level, CBNA ranks either first or second in 41 of the 50 towns where it does business, and is the "only bank in town" in 21 of these communities.

CBSI is also parent to Benefit Plans Administrative Services, Inc. (BPA), a pension administration and consulting firm located in Utica, New York, serving sponsors of defined benefit and defined contribution plans.





## The Financial Services Group

As the "local bank" in each of our market areas, our customers trust Community Bank for the type of personal service they expect. Often this means much more than day-to-day banking, with greater emphasis on long-term financial services. At Community Bank, our customers are covered by a full range of financial planning products and services, helping them to build toward a secure future.

### **Financial Planning**

The strength of sound financial planning is the ability of the Financial Service Representative (FSR) to understand the particular needs of the customer—both immediate and long-term. Only then can the representative help them decide on the plan that will best meet their financial goals.

At Community Bank, our NASD licensed Financial Service Representatives value the customer relationship.

Our established roots in the community make us an easily accessible resource, with a high level of personal service. It is our commitment to professionally assist the client with their overall financial needs, treating them as a valued customer, and not simply a transaction.

In 1998, Community Bank created a new subsidiary—Community Investment Services, Inc.—to offer all of the products and services of a full-service brokerage firm, including stocks, bonds, mutual funds and annuities, all from under the umbrella of the financial institution our customers have known for years. In addition, through Community Financial Services, Inc., we now offer affordable Life and Health insurance services for individuals or groups.

Ten skilled FSRs are available to serve our clients through any of our offices.



**Seated L.-R.:** Susan A. Mann, Waterloo; Pamela L. Konieczka, Administrative Assistant, Olean; Paul J. Snodgrass, Ogdensburg

**Standing L.-R.:** Michael A. Patton, Regional President-Trust Officer/Director Financial Services, Olean; Larry R. Schultz, Geneva; Herbert E. Rice, Sherman; Joseph M. Butler, Jr., Watertown; Lynn C. Rowland, Corning; Kevin C. Gildner, Olean; and Charles E. (Bud) Kopp, Financial Services Manager, Olean

**Not Pictured:** Daniel P. Drappo, Black River; Candace L. Kowal, Gowanda





## "Partners in Your Financial Future"

### **Trust Services**

At Community Bank, our greatest asset is the strength of our customer relationships. That strength is based upon the breadth of our understanding of the customer's individual needs. Our Trust Department has the experience and skills to analyze their financial goals, recommend a personal financial plan, and, if requested, manage their affairs professionally and confidentially. And all clients are served locally—by the experts they know they can rely on.

We offer a number of services to help the customer plan for the future, protect their hard-earned assets, and benefit from our professional expertise. Because we're local, our clients can be assured that we are always available to answer their questions. While asset protection is critical, at Community Bank we know the real benefit of Trust Services to our customers is peace of mind.

After a thorough review of the customer's particular needs and financial objectives, we will recommend the services that will best serve those needs. Whether it is the safekeeping of assets, becoming your financial secretary, assisting with your estate plan, or meeting your investment management or retirement planning needs, our Trust Department is committed to helping our customers prepare for the future.

### **Benefit Plans Administrative Services (BPA)**

Through Benefit Plans Administrative Services, Inc., Community Bank serves the pension, retirement and trust requirements of both large and small businesses in our communities. BPA's strength lies in its ability to offer consulting services for both custom-designed plans, as well as an independent and broad range of related investment products. And all BPA customers are served by a team of qualified, professionally trained staff.

BPA representatives work closely with our clients to ensure that their benefits plan continues to meet the ever-changing needs of business and a challenging financial landscape. Our mission is to provide clients with competitive financial packages for their employees that are affordable and easy to administer.

BPA represents more than 350 companies with a total of more than \$140 million in pension trust assets. This success, coupled with the dedicated service provided by the BPA staff, helps our business customers build a bright future for the working families of our communities.



**Seated L.-R.:** Carmen A. Camp, Personal Trust Officer, Canton; Kenneth O. Winans, Trust Investment Officer, Olean

**Standing L.-R.:** Barry S. Kublin, Executive Vice President, Employee Benefit Trust, BPA – Utica; Catherine B. Koebelin, Vice President – Personal Trust Officer, Olean; Patricia E. Barie, Personal Trust Officer, Olean; Michael A. Patton, Regional President-Trust Officer/Director Financial Services, Olean; and Robert A. Malczyk, Sales Manager-BPA, Utica

**Not Pictured:** Thomas J. Hart, Personal Trust Officer, Corning



**Standing L.-R.:** Linda Kies, Vice President Finance; Linda Pritchard, Vice President Operations;

**Seated L.-R.:** Barry S. Kublin, Executive Vice President; Girard H. Mayer, President & CEO



## Quality Products

### Reaching new customers with "Real Speak."

In 1998, we named Syracuse-based LP&M Advertising as our new agency of record.

LP&M revamped our print and broadcast advertising approach, introducing the new "Real Speak Campaign" in our communities throughout the Bank Regions. The campaign, which was carried out in newspaper ads and 60-second radio spots, was designed to target specific demographic segments of our markets, and allow the reader to identify with the people featured in the ads. The ads are designed to build Community Bank's image in its acquired, expanded markets. This image, or brand positioning, combines high-quality products, service and well-trained staff with quick, local decision-making as the centerpiece of its relationship-building strategy.

The print ads employ stark portraits of "real people," with headlines written in "real speak" testimonial language. The ads create a strong positive image for Community Bank, while also "linking" specific bank products in the diamond-shaped box which was designed from a section of our chain-link CBNA logo.

The print campaign also introduced a unified graphic design, and the individual ads are modular so that product offerings may be changed to maximize use of the photography.



*We know refinancing will save us money. But does it have to cost so much money?*

**Refinance now and pay NO CLOSING COSTS†**

Refinance now, pay no closing costs, and take advantage of today's attractive rates. And with our personal service and local decision-making, you'll always get prompt, hassle-free answers.

Lowering your rate by even a single percent could save you thousands. Ask about a no-closing-cost new mortgage or home equity loan, too. That's banking *your* way, at COMMUNITY BANK, N.A.

*Banking your way!*

**COMMUNITY BANK, N.A.**

*Also, see us for IRAs, auto loans, savings and checking accounts.*

† Valid on owner-occupied, 1-4 family properties. Customer must provide hazard insurance coverage. For mortgages with less than 20% down payment, Private Mortgage Insurance (PMI) is required and customer is responsible for PMI premiums. No closing costs means: no points, title insurance fee, application fee, flood check fee, credit report, mortgage recording fee, abstract title or search fee, appraisal fee, or bank attorney fee. If customer selects an attorney to represent him/her, customer is responsible for attorney fees. Other fees/charges, if applicable, are the responsibility of the customer. Should the no-closing-cost mortgage be closed or discharged within the first three years, the Bank may collect the closing costs from the customer which were waived when the loan was opened.



*Electronic banking? That's OK. Higher CD rates? Now you're talking.*

**COMMUNITY BANK, N.A.**

*Not every banking product is right for everyone. That's why we offer high-tech services and high-yield investments - like our CDs. You'll find a variety of options to make your investments grow. All delivered with prompt, personal attention and a friendly smile. That's banking *your* way, at COMMUNITY BANK, N.A. See us soon for current rates.*

*Also, see us for trust accounts, home equity loans and investment services.*



*I want a bank that not only knows my company's name. But my company's needs, too.*

**COMMUNITY BANK, N.A.**

*Long-distance financial service just doesn't work. Your business needs a local bank - making prompt, local decisions. So we offer all the big out-of-town banks plus the personal attention and quick response others can't provide. That's banking *your* way, at COMMUNITY BANK, N.A. Talk with us soon.*

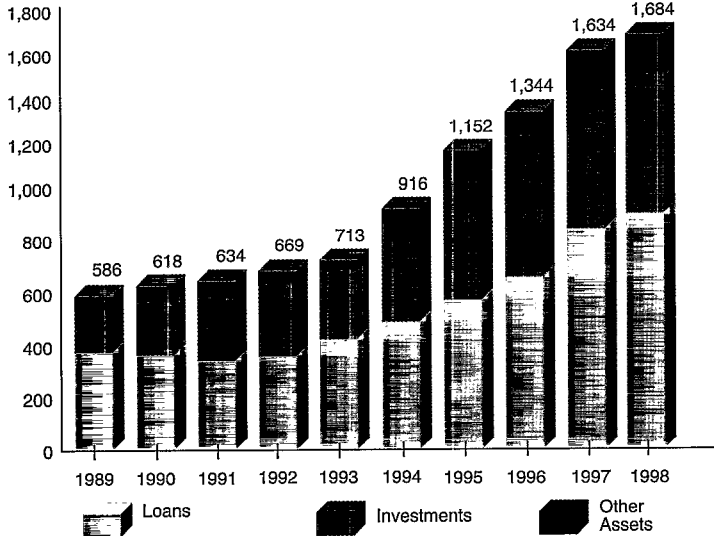
*Also, see us for all your personal banking needs.*

† Ranked #1 by the U.S. Small Business Administration among banks with 2001 billion.



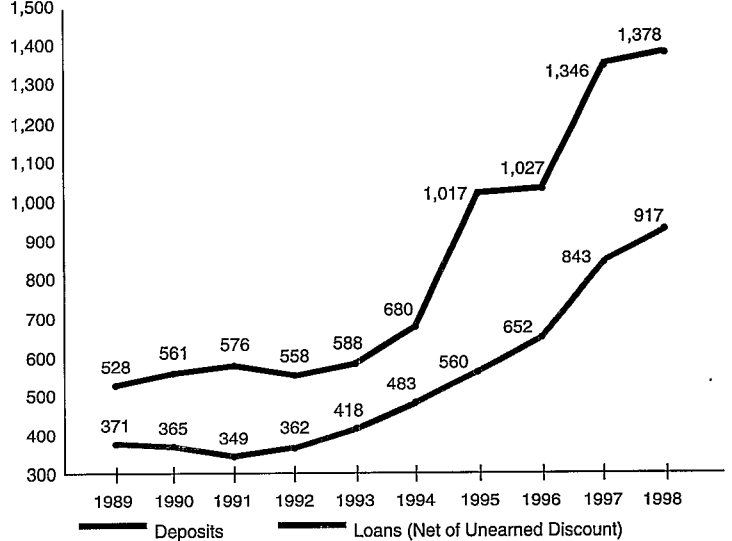
## Consolidated Ten Year Financial Trends

**ASSET TREND (Year End)**  
(\$ million)



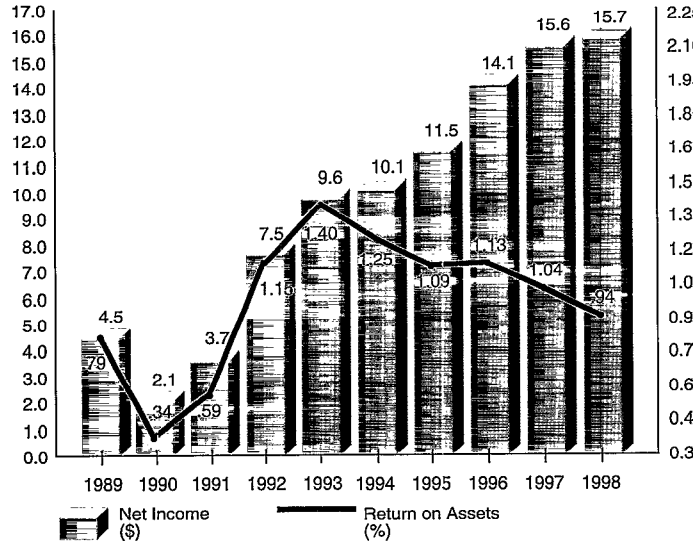
Asset growth has accelerated since 1994 as a result of strategic acquisitions of branches which have filled in or extended CBSI's expansive branch market area. In all, 39 branches were acquired largely from superregional banks, of which 10 have been subsequently sold or combined for greater efficiency. No viable branch purchase opportunities were identified in 1998, and for much of the year, cash flow from the Bank's investment portfolio was used to fund loan growth and pay down borrowings rather than be reinvested.

**LOAN AND DEPOSIT TREND (Year End)**  
(\$ million)



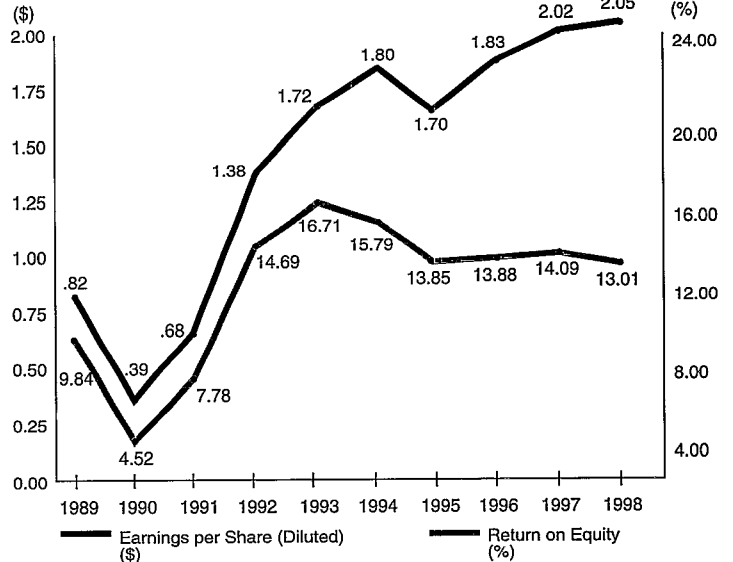
While the Bank's early branch acquisitions were largely deposit-oriented, 1997's growth included both substantial loan and deposit purchases. Loans in the former Chase branches acquired in 1985 have increased by nine and one half times, and of the 8.8% loan growth in 1998, nearly 38% came from branches purchased in mid-1997. This year's increase in loans, which reflects more conservative consumer underwriting standards, follows upon five consecutive years of loan growth in excess of 15% per annum (excluding acquired loans).

**EARNINGS TREND**  
(\$ million)



Earnings reached a record level in 1998, albeit growth was lessened largely due to the impact of a flat Treasury yield curve on earning asset margins, reduced consumer borrowing, the liquidation of investments to repurchase CBSI stock, and the absence of further corporate tax-reduction opportunities. The overall return on assets trend reflects the impact of premiums paid for acquisitions as well as a greater portion of acquisition-related earning assets being in investments, which are being steadily redeployed in higher yielding loans over time.

**SHAREHOLDER RETURN TREND**

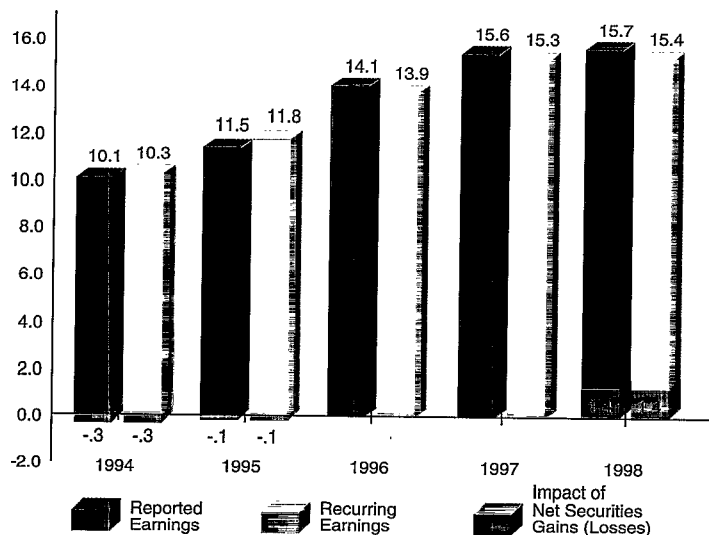


Earnings per share (EPS) resumed its record growth for the third year (up 1.5%) following initial dilution caused by the Chase branch acquisition in 1995. Integral with its practice to manage capital to maximum shareholder advantage, the Company repurchased 326,600 shares of its common stock last fall, of which the benefits on earnings per share and return on equity (ROE) began to be realized in fourth quarter 1998. ROE dipped in 1998 due to reduced earnings growth after two years of improvement following CBSI's common stock offering in mid 1995.



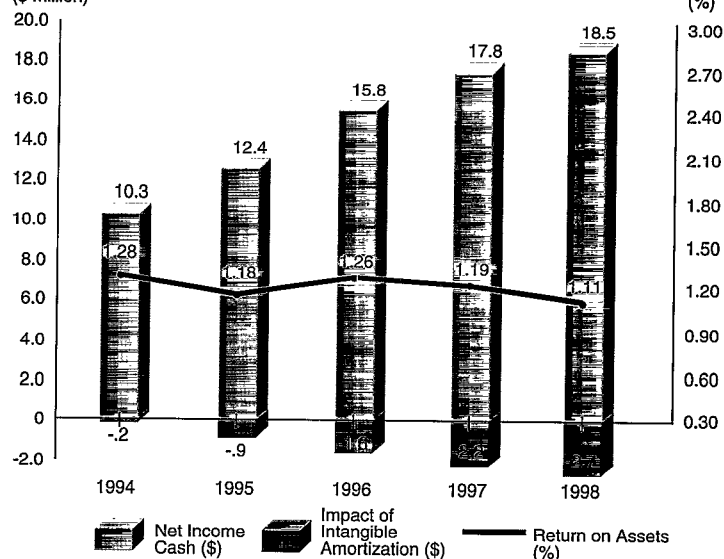
## 1998 Financial Performance Capsule

### NET INCOME (\$ million)



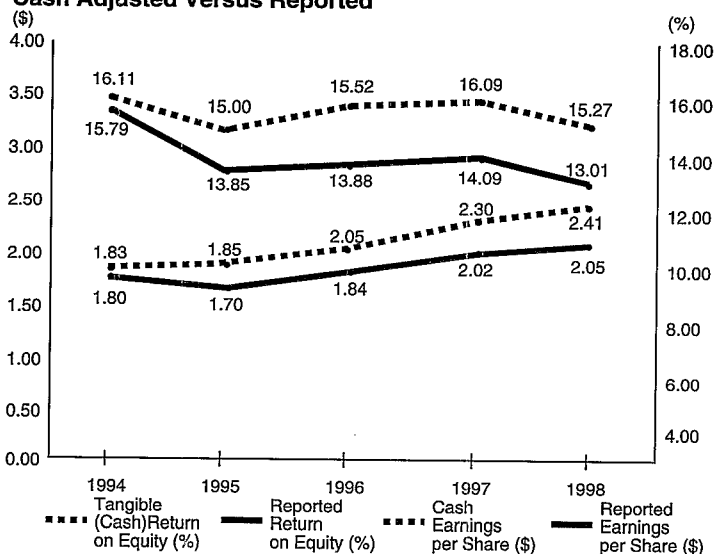
Reported earnings increased 1.1% in 1998 while recurring earnings, which includes the Company's practice of realizing net securities gains (losses) when economically justified by total return analysis, rose by .9%. The \$320,000 higher level of reported earnings reflects the excess of a variety of one-time revenues over \$577,000 in net losses realized on disposition of acquired branch properties. The flatness in recurring income for the first time in many years reflects 1998's highly unusual circumstances.

### EARNINGS TREND - Cash Adjusted (\$ million)



Many analysts consider that a better measure of the economic value of an acquisition are the cash earnings it generates, which is determined by adding back to reported earnings the after-tax expense of amortizing the acquisition premium. On that basis, CBSI's cash earnings increased 4.5% in 1998 compared to 12.6% in 1997. Return on assets is also significantly higher on a cash versus reported basis, 17 and 15 basis points more in 1998 and 1997, respectively.

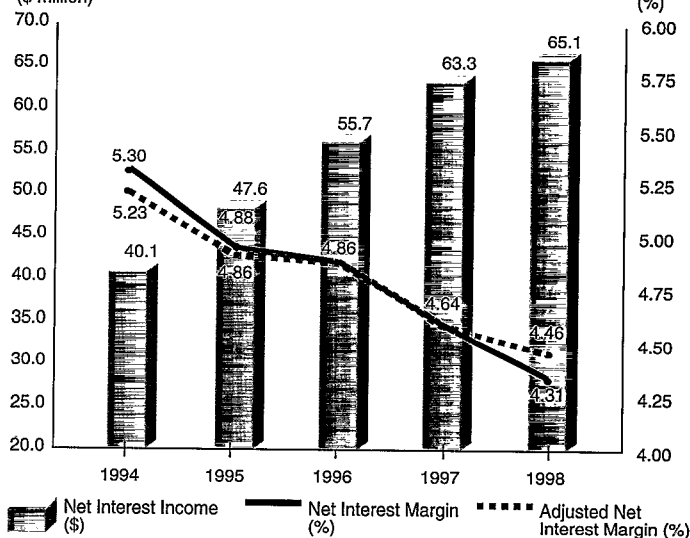
### SHAREHOLDER RETURN TREND Cash Adjusted Versus Reported



Reported earnings per share-diluted (EPS) increased 1.5% in 1998 to \$2.05 versus a 4.7% increase on a cash basis to \$2.41. The greater rate of cash EPS improvement in 1998 and over time reflects the increasing impact of intangible amortization on reported results as the full-year impact of the Company's 1995 and 1997 branch acquisitions is experienced. Performance measured by tangible or cash return on equity also showed increasingly better than reported results, with 1998's level of 15.27% being nearly in the top performance quartile of CBSI's peer banks.

### NET INTEREST INCOME

Full Tax-Equivalent Basis  
(\$ million)

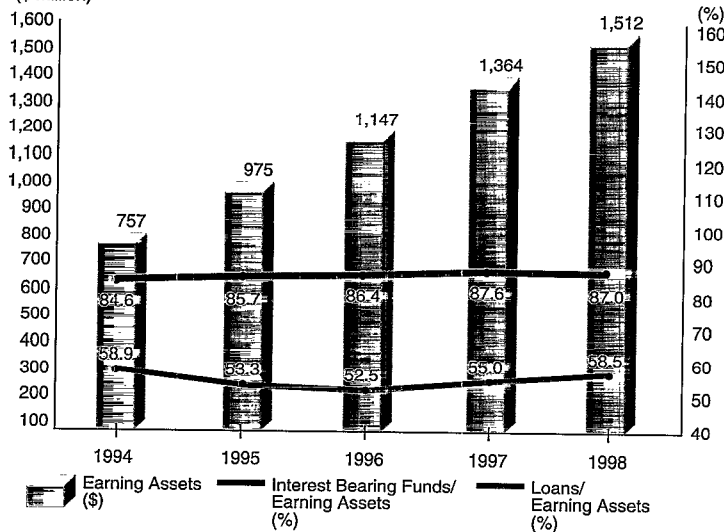


Net interest income has risen steadily over the five year period, though the 2.8% increase in 1998 is the smallest rate of improvement owing to lower earning asset growth and decreased margins. The latter reflects the impact of a flat Treasury yield curve in general and a reduction in investment portfolio yield in particular. To mitigate these impacts, gains were taken on selected securities previously purchased to protect the Bank's income stream in a falling rate environment such as this year. Including these gains, the reduction in adjusted net interest margin was held to 19 basis points in 1998.



## EARNING ASSET COMPARISONS

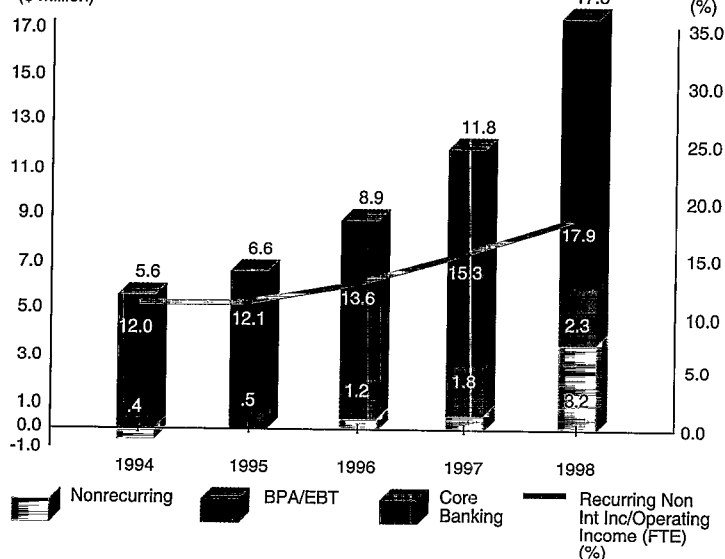
Average Balances  
(\$ million)



Average earning assets grew 10.9% in 1998, registering the full-year impact of \$183 million in earning assets added in mid 1997 from acquisitions. Growth during 1998 was held to 3.3% due a net reduction in the Bank's investment portfolio and comparatively moderate growth in loans. Interest-bearing funds as a percent of earning assets turned down slightly due to reduced borrowings and proportionately greater funding by demand deposits made possible by unusually strong growth. Loans to earning assets continue to climb as planned loan growth occurs in newly acquired markets.

## NONINTEREST INCOME

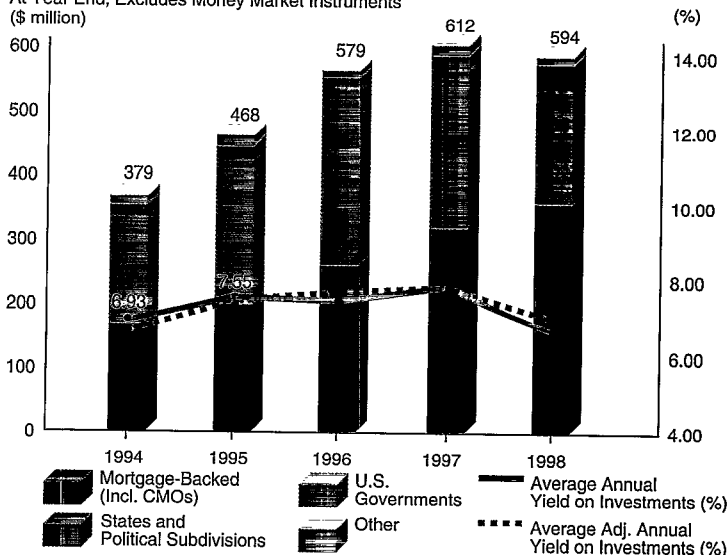
(\$ million)



Noninterest income increased 47% this year compared to 33% in 1997. More importantly, income from recurring sources rose 24% on top of the prior year's 31% rate, signifying less dependence on product revenues susceptible to interest rate fluctuation as indicated by the rise in the ratio to operating income. Growth resulted from higher overdraft fees and other miscellaneous service charges, expanded mutual fund sales, and greater pension administration and investment management revenues generated by Benefit Plans Administrative Services, Inc. (BPA), acquired in mid 1996.

## INVESTMENT PORTFOLIO PERFORMANCE

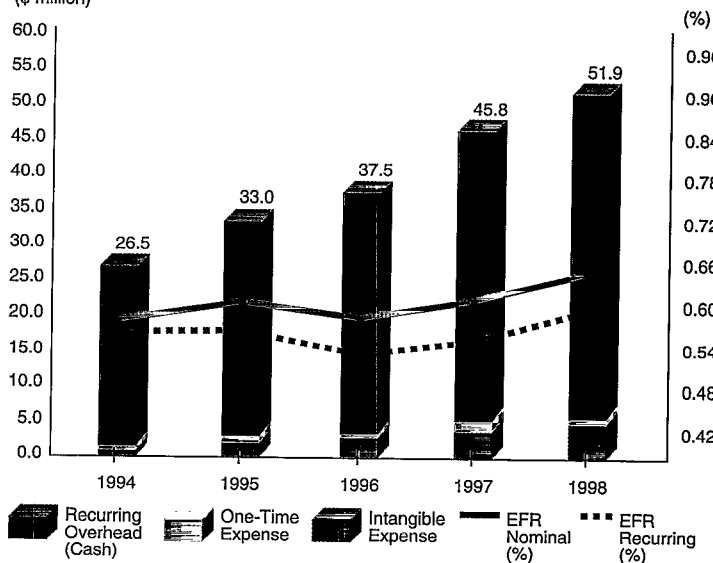
At Year End, Excludes Money Market Instruments  
(\$ million)



Largely because of fewer attractive investment opportunities caused by 1998's flat Treasury yield curve, the investment portfolio was allowed to run off for much of the period, down 3.4% for the year. The portfolio yield was particularly impacted by unusually high mortgage refinancing nationwide, which reduced interest income on holdings of premium collateralized mortgage obligations. This reduction was partially offset by gains taken on securities when economically justified by total return analysis. Including those gains, the adjusted investment yield fell approximately  $\frac{3}{4}$  of a point.

## OVERHEAD EFFICIENCY

(\$ million)



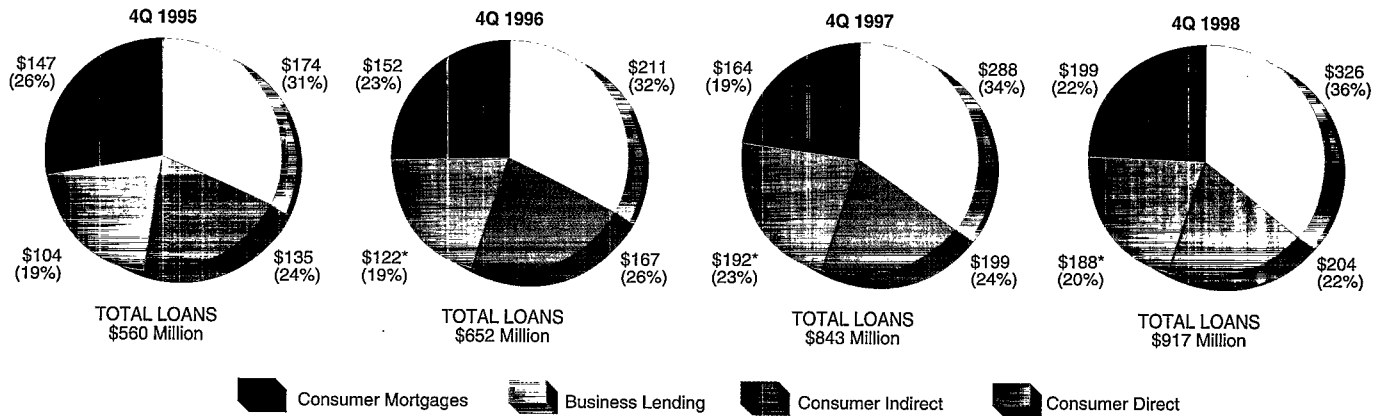
Noninterest expense rose 13% in 1998 owing to the full-year impact of 1997's acquisitions, which in turn caused that year's expenses to climb 22%. One-time expenses were a significantly reduced factor in overhead performance in 1998. The Company's recurring efficiency ratio (which also excludes non-cash intangible amortization) rose again this year, largely the result of a reduction in net interest income caused by a reduction in margin. Underlying overhead control is good, up 2.9% excluding one-time items for fourth quarter 1998 versus the comparable 1997 period.



# 1998 Financial Performance Capsule

## NATURE OF LENDING

Mix at Quarter End  
(\$ Million and %)



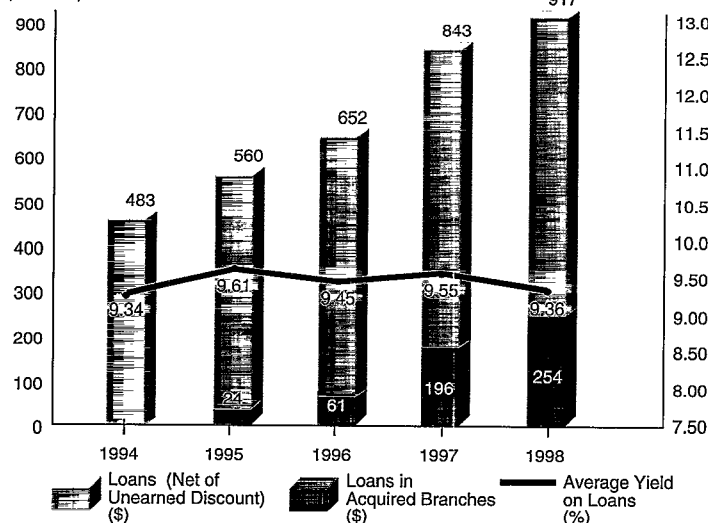
NOTE: Loans are Net of Unearned Discount

\* Includes Fixed Rate Home Equity Loans Formerly Categorized in Consumer Mortgages

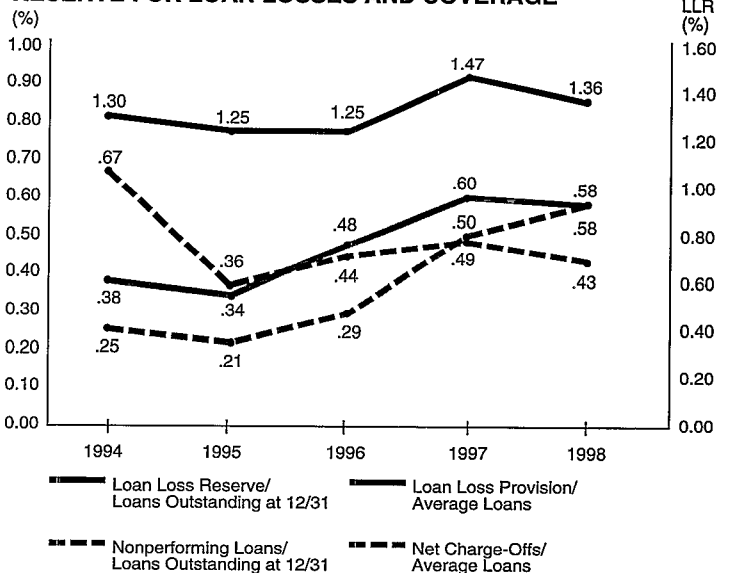
CBSI is predominantly a retail bank, with nearly two-thirds of its loans outstanding oriented to consumers borrowing on an installment and residential mortgage basis. Lending to small and medium-sized businesses has increased by almost 1.9 times over the last three years, increasing their share of the loan portfolio from 31% to 36%. Over 85% of customers borrow less than \$100,000 (representing about 32% of loans outstanding) while under 1% of customers borrow over \$1 million (or 22% of loans outstanding). The next largest slice of the portfolio or 22% consists of indirect installment loans originated through dealers; all but 7% are automobile loans, of which 72% are for used vehicles. Expansion slowed dramatically in 1998 due to tighter credit standards. In addition, direct consumer loans originated at CBSI's branches (including home equity loans) decreased slightly this year; the large increase in 1997 primarily reflects loans associated with branches acquired from Fleet Bank. The consumer mortgage segment grew faster (up 21%) than any of the other three portfolio segments, indicative of record-high mortgage refinancing activity nationwide and targeted promotions in CBSI's market areas; secondary market originations/sales were nearly 4.5 times more than 1997's originations.

## LOAN TREND AND YIELD

Outstanding at Year End  
(\$ million)



## RESERVE FOR LOAN LOSSES AND COVERAGE



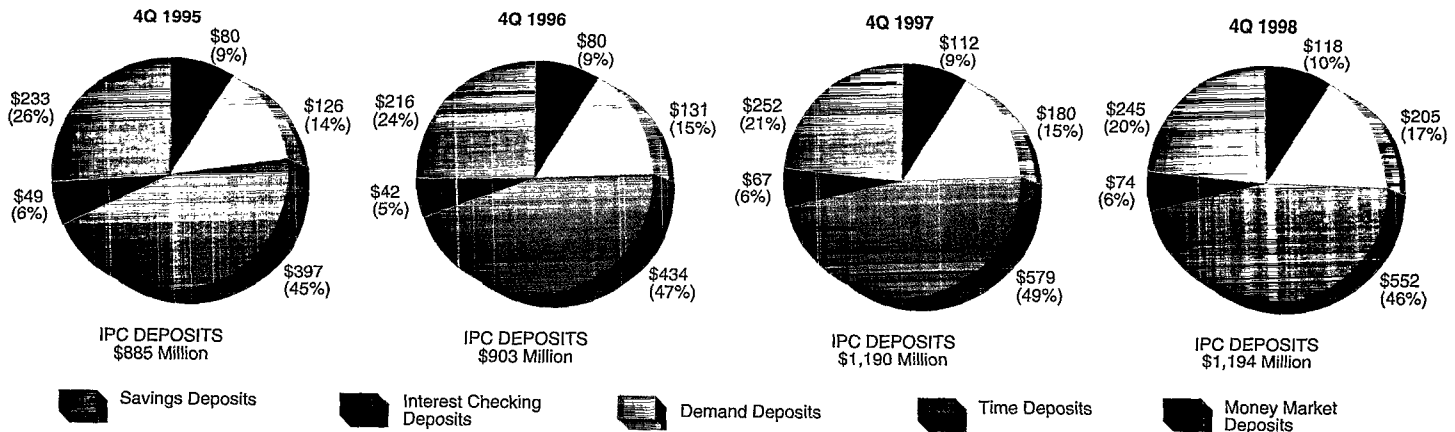
Loans climbed 8.8% in 1998, despite tighter credit standards on indirect installment lending, increasingly competitive pricing, and over \$39 million in secondary mortgage market sales. Nonetheless, this was the first year since 1992 that loan growth (excluding acquired branch loans) has not exceeded 15% per annum. Important to the Company's strategic success, without the loans generated in the former Chase branches acquired in mid 1995 and Key and Fleet branches in mid 1997, loan growth would have been limited to 9.5% in 1997 and 2.4% in 1998. Loan yields have been relatively steady during the period, consistently above peer norms due to a favorable mix of consumer and small business loans.

After unusually good experience in the 1993-1996 period, the net charge-off ratio increased substantially in the 1997-1998 period, with consumer installment charge-offs explaining 80-90% of the change during the period. Actions have been taken that have reduced the charge-off ratio from its high of .76% in fourth quarter 1997 to .55% in fourth quarter 1998. Based on management's assessment of the adequacy of the loan loss reserve, the loan loss provision equally covered charge-offs in 1998 as opposed to the prior years' excess coverage. The nonperforming loan ratio has been consistently low since 1995, and is amply covered by the loan loss reserve at 3.1 times versus 2.6 times for peers.



## CORE DEPOSIT MIX

Average 4th Quarter Balances  
(\$ Million and %)

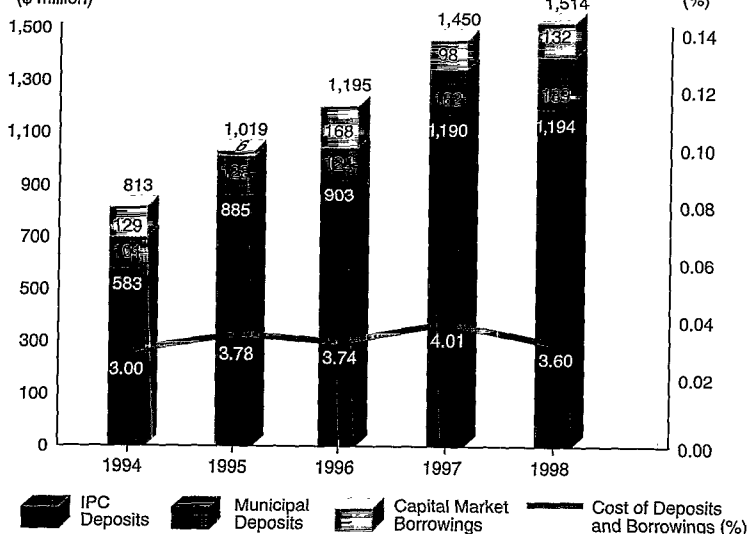


Note: 1995 IPC Deposits exclude Deposits in Branches sold to NBT Bank, N.A. on December 15, 1995.

CBSI's funding sources benefit from a high level of stable core deposits, as measured by being in the top peer quartile. These relatively low cost deposits are comprised of a mix of transaction and non-transaction account types, and are held by individuals, partnerships, and corporations who have the potential to be cross-sold a variety of loan and other financial service-related products. Fourth quarter deposit levels were virtually unchanged in 1998 compared to strong increases in the four previous years due to branch acquisitions. Reflective of continued commercial loan growth and, more importantly, a lower opportunity cost of funds, the share of transaction accounts rose this year after being relatively flat since 1995. Conversely, holdings of time deposits (CDs) decreased both proportionately and absolutely following previous years' steady increases caused by the mix of certain acquired branch deposits and consumer movement away from immediately available, lower earning savings and money market accounts. Excluding acquisitions over the period, IPC deposits grew .3% this year compared to 1.8% in 1997 and 3.7% in 1996.

## SOURCES OF FUNDS

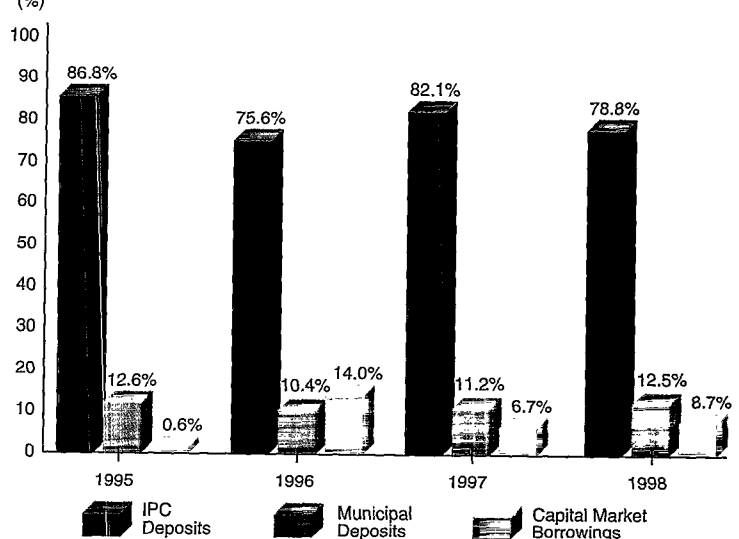
Average 4th Quarter Balances  
(\$ million)



The level and mix of CBSI's three primary funding sources, which exhibit a variety of maturity, stability, and pricing characteristics, have varied according to relative cost, availability, and asset/liability management objective. Deposits of local municipalities are substantial, being over the 90th peer percentile, and are managed according to the long-term profitability of overall relationship at a price generally the same or below capital market borrowings. The average cost of all funds reflects competitive factors and management of interest rate sensitivity, with the reduction in 1998 made possible by a lower interest rate environment.

## SOURCES OF FUNDS MIX

Based On Average 4th Quarter Balances  
(%)



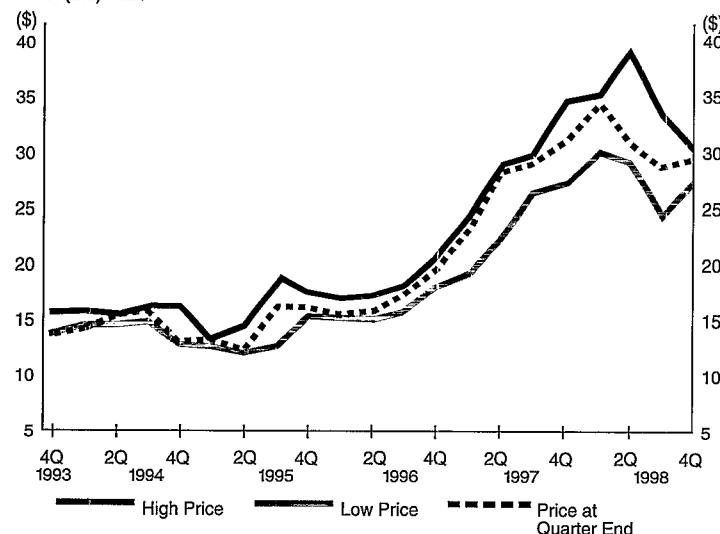
The changes in funds mix have most dramatically been influenced by the timing of acquisitions, as illustrated by the 1994-95 and 1996-97 patterns. Borrowings have been incurred to fund specific securities strategies to pre-invest anticipated cash to be received from acquisitions in excess of loans, largely to be repaid by lower cost deposits upon consummation of the acquisition. In addition, CBSI's \$30 million Trust Preferred Securities borrowing in 1997 capitalized that year's acquisitions. Opportunities to lock in attractively priced term borrowings also periodically occur, which explains the growth in 1998.



## 1998 Financial Performance Capsule

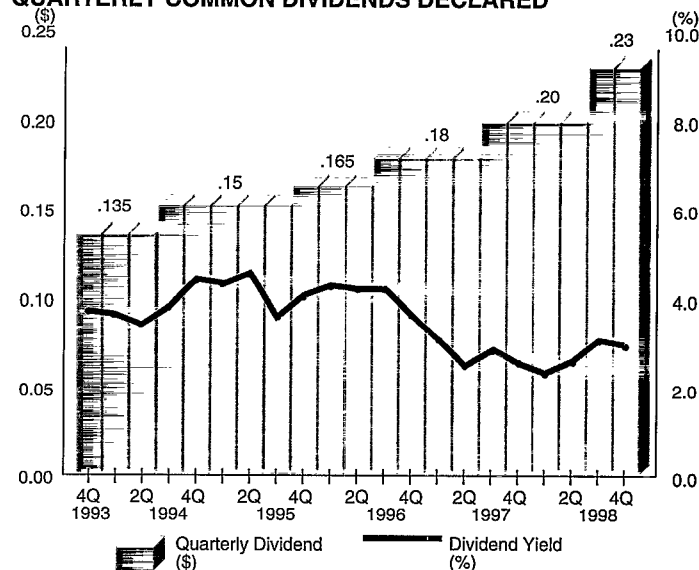
### COMMON STOCK PERFORMANCE

NYSE Symbol: CBU Newspaper Listing: CmntyBkSys  
Market (Bid) Price



CBSI's common stock price has increased at an exceptional 27% rate per annum over the last five years, including reinvestment of dividends. Many analysts attribute this performance to the Company's steady earnings growth, effective use of strategic acquisitions to help sustain this growth, and the overall increase in valuations of bank stocks as measured by price/earnings multiples. The \$2 or 6.4% decrease in CBSI stock price during 1998 reflects both the general trend for banks of similar market capitalization as well as specific factors causing the Company's reduced rate of earnings growth.

### QUARTERLY COMMON DIVIDENDS DECLARED



The Company's common dividend payout has regularly been in the 30-40% range, balanced between the need to retain capital to support earning asset growth and the desire of investors who prefer a dividend component of investment return that may be more predictable than capital appreciation. As such, common dividends have increased eight times in the last seven years. The dividend yield has been in the comparatively favorable 2.5%-3.0% range over the last two years, down from earlier years when stock valuations for CBSI and banks in general were lower and yields conversely higher.

### Common Stock Shareholder Profile

(As of Date Indicated or Most Recent Preceding Date)

	12/31/98		12/31/97		Change	
Number of Shares Outstanding	7,296,000		7,587,000		(291,000)	
Number of Shareholders	4,206		3,618		588	
	% Shares Out-standing	# of Share-holders	% Shares Out-standing	# of Share-holders	% Shares Out-standing	# of Share-holders
Institutional Shares Held Per 13-F Filings	38.2%	43	25.2%	29	13.0 %	14
Other Significant Shareholdings						
Insiders*	9.4%	13	6.9%	14	2.5 %	(1)
Owners of 5% or More	0.0%	0	0.0%	0	0.0 %	0
CBSI's 401(k), excl. Insiders (26.0% and 29.2% of Plan Dollars)	2.8%	515	2.4%	476	0.4 %	39
CBSI's Pension Plan (8.6% and 12.0% of Plan Dollars)	0.5%	1	0.5%	1	0.0 %	0
Total Other Shareholdings	12.7%	529	9.8%	491	2.9 %	38
Dividend Reinvestment Plan						
Participation	16.1%	677	17.3%	624	(1.2) %	53
All Shares Held by Participants	8.2%		7.4%		0.8 %	

\*Includes estimate of shares which insiders have the right to acquire within 60 days of March 22, 1999 and March 23, 1998, respectively, through the exercise of stock options.





## Subsidiaries

### COMMUNITY BANK, N.A.

#### OFFICES

Administrative Office - 5790 Widewaters Parkway, DeWitt NY 13214-1883

Northern Region Office - 45-49 Court Street, Canton NY 13617-0509

Southern Region Office - 201 North Union Street, Olean NY 14760-0690

#### EXECUTIVE

Sanford A. Belden, *President and Chief Executive Officer, DeWitt*

#### BANKING

James A. Wears, *Regional President, Northern Region, Canton*

##### Lending

###### Canton

Richard H. Porter, *Vice President, Senior Commercial Loan Officer*

Robert F. Zehr, *Vice President, Indirect Loan Manager*

Bradley L. Ward, *Vice President, Commercial Loan Officer*

###### Watertown

Michelle D. Pfaff, *Vice President, Commercial Loan Officer*

William T. LeRoy, *Vice President, Commercial Loan Officer*

Edward C. Ward, *Assistant Vice President, Agricultural Loan Officer*

###### Lowville

Andrew B. Rice, *Assistant Vice President, Agricultural Loan Officer*

##### Branch Services

Claire F. LaGarry, *Vice President, Branch Coordinator, Canton*

Michael A. Patton, *Regional President/Trust Officer, Southern Region, Olean*

##### Lending

###### Olean

Brian D. Donahue, *Regional Vice President, Senior Loan Officer*

Earl R. Withers, Jr., *Vice President, Retail Loan Manager*

James E. Kennedy, *Vice President, Commercial Loan Officer*

Kevin P. Gallivan, *Commercial Loan Officer*

Mark P. Saglimben, *Vice President, Commercial Loan Officer*

James M. Kelly, *Vice President, Retail Banking Sales Manager*

Richard M. Heidrick, *Vice President, Indirect Loan/Collections Manager*

###### Waterloo

Paul E. Lepore, *Vice President, Commercial Market Manager*

Richard R. Sisson, *Vice President, Retail Banking Sales Manager*

James M. King, *Assistant Vice President, Agricultural Loan Officer*

###### Wellsville

Douglas O. Frank, *Vice President, Commercial Loan Officer*

###### Newark

Terrence W. Baker, *Vice President, Commercial Loan Officer*

###### Canandaigua

David W. Feerman, *Vice President, Commercial Loan Officer*

###### Corning

J. David Clark, *Vice President, Commercial Market Manager*

William J. Pope, *Vice President, Retail Banking Sales Manager*

James F. Ells, *Assistant Vice President, Commercial Loan Officer*

###### Gowanda

Brian F. Aldrich, *Agricultural Loan Officer*

###### Jamestown

Roger E. Dickinson, *Vice President, Commercial Loan Officer*

##### Branch Services

Judith A. Meyer, *Vice President, Branch Coordinator, Olean*

### INVESTMENTS AND ASSET/LIABILITY MANAGEMENT

Joseph J. Lemchak, *Vice President, DeWitt*

### TRUST SERVICES

#### Employee Benefit Trust

Robert A. Malczyk, *Sales Manager, Utica*

#### Personal Trust

Catherine B. Koebelin, *Vice President, Trust Officer, Olean*

Thomas J. Hart, *Trust Officer, Corning*

Kenneth O. Winans, *Trust Investment Officer, Olean*

Carmen A. Camp, *Trust Officer, Canton*

#### Financial Services Representatives

Charles E. Kopp, *Manager, Olean*

Daniel P. Drappo, *Black River*

Lynn C. Rowland, *Corning*

Larry R. Schultz, *Geneva*

Paul J. Snodgrass, *Ogdensburg*

Helen M. Willman, *Jamestown*

Susan A. Mann, *Waterloo*

Joseph M. Butler, Jr., *Watertown*

Kevin C. Gildner, *Olean*

Candace L. Kowal, *Gowanda*

### FINANCE

#### DeWitt

David G. Wallace, *Senior Vice President and Chief Financial Officer*

Charles M. Ertel, *Vice President, Corporate Accounting Manager*

Ann M. Money Penny, *Assistant Vice President, General Accounting Manager*

Richard A. Chapin, *Vice President, Financial Systems Manager*

Harold M. Wentworth, *Assistant Vice President, Financial Analysis Manager*

### OPERATIONS

Timothy J. Baker, *Vice President, Senior Operations Officer, Canton*

William L. Sprague, *Vice President, Operations Manager, Olean*

Daniel R. Phillips, *Assistant Vice President, Microcomputer Resources Manager, DeWitt*

#### Northern Region

Harry J. Lee, *Vice President, Deposit Operations Manager, Canton*

Patricia A. Tabolt, *Assistant Vice President, Loan Operations Manager, Canton*

#### Southern Region

Nancy M. Lewis, *Assistant Vice President, Deposit Operations Manager, Olean*

Helyn E. Wilson, *Assistant Vice President, Loan Operations Manager, Olean*

### ADMINISTRATION

Dianne L. Parks, *Vice President, Compliance Manager, Canton*

Steven C. Byington, *Vice President, Marketing Manager, DeWitt*

Susan D. Abbott, *Vice President, Human Resources Manager, DeWitt*

Elaine A. Saarinen, *Assistant Vice President, Purchasing Manager, Canton*

Donna J. Drengel, *Secretary, Board and Shareholder Relations, DeWitt*

### AUDIT

W. Valen McDaniel, *Vice President, Corporate Auditor and Risk Manager, DeWitt*

Lynne M. Wadsworth, *Assistant Vice President, Audit Manager, DeWitt*

Joseph B. Jacobs, *Assistant Vice President, Security Officer, Waterloo*



## Subsidiaries

### COMMUNITY BANK, N.A.

#### BRANCH OFFICES

##### Northern Region

###### Black River

Christina S. Meagher, *Manager*

###### Boonville (101 Main Street & Headwaters Plaza))

Kevin J. Kent, *Vice President, Manager*

###### Canton

Donald A. Blount, *Vice President, Manager*

###### West Carthage

Gerald S. Morrow, *Assistant Vice President, Manager*

###### Clayton

Amy L. Hunter, *Assistant Vice President, Manager*

###### Gouverneur

Kenneth W. Snyder, *Vice President, Manager*

###### Harrisville

Marlys A. Lesperance, *Assistant Cashier, Manager*

###### Heuvelton

R. Jean Pray, *Assistant Cashier, Manager*

###### Lowville (7605 State Street and 7395 Turin Road)

Adam J. Smykla, *Vice President, Manager*

###### Madrid

Marsha L. Watson, *Manager*

###### Massena

Ronald S. Rickett, *Vice President, Manager*

###### Norwood

Sandra A. Ginn, *Assistant Cashier, Manager*

###### Ogdensburg (320 Ford Street, Gateway Plaza and Seaway Shopping Center)

Robert L. Seymour, *Vice President, Manager*

###### Old Forge

Barbara B. Criss, *Manager*

###### Port Leyden

Nancy A. Evans, *Assistant Cashier, Manager*

###### Potsdam (64-70 Market Street and May Road)

Joyce E. Lalonde, *Vice President, Manager*

###### Pulaski

Steven P. Gaffney, *Assistant Vice President, Manager*

###### St. Regis Falls

Patricia A. Susice, *Manager*

###### Star Lake

Corina L. Kelley, *Assistant Cashier, Manager*

###### Waddington

Brenda L. Matthie, *Branch Supervisor*

###### Watertown (1125 Arsenal Street)

Elizabeth A. Brown, *Assistant Vice President, Manager*

###### Watertown (216 Washington Street)

Stephanie A. McGuire, *Vice President, Manager*

##### Southern Region

###### Olean Market

###### Alfred

Cheri A. Horton, *Manager*

###### Allegany

Mary M. Quigley, *Assistant Vice President, Manager*

###### Cassadaga

Lee R. Johnson, *Manager*

###### Clymer

Linda L. Anderson, *Manager*

###### Cuba

Jody L. Collins, *Assistant Vice President, Manager*

###### Gowanda

Sandra T. Gaylord, *Assistant Vice President, Manager*

###### Houghton College

David B. Fleming, *Manager*

###### Jamestown

Joann W. Anderson, *Manager*

###### Olean (201 North Union Street)

James M. Kelly, *Vice President, Retail Banking Sales Manager*

###### Olean (Delaware Park)

S. Lynn Guntow, *Manager*

###### Portville

Beverly J. Geise, *Manager*

###### Ripley

Patricia J. Knight, *Manager*

###### Sherman

William C. Brosius, *Manager*

###### Wellsville (99 Main Street and 4196 Bolivar Road)

Donald E. Charles, *Vice President, Manager*

##### Corning Market

###### Addison

Paulena A. Webster, *Assistant Vice President, Manager*

###### Corning

Douglas A. Mitchell, *Vice President, Manager*

###### Corning North

Cynthia D. Mathis, *Vice President, Manager*

###### Corning South

Lucy F. Camilo, *Manager*

###### Hammondsport

Donnette J. Wager, *Manager*

###### Nichols and Owego

Samuel F. Thomas, *Vice President, Manager*

###### Penn Yan

Marilyn L. James, *Vice President, Manager*

###### Woodhull

James R. Crans, *Vice President, Manager*

##### Finger Lakes Market (East)

###### Cato

Linda L. Martin, *Assistant Cashier, Manager*

###### Hannibal

Debra A. Davis, *Manager*

###### Interlaken

Paul V. Odell, *Assistant Vice President, Manager*

###### Ovid

Joyce A. Tavelli, *Assistant Vice President, Manager*

###### Seneca Falls

Betty A. Verzillo, *Assistant Vice President, Manager*

###### Skaneateles

Robert E. Marsh, *Manager*

##### Finger Lakes Market (West)

###### Canandaigua

Deborah J. Rought, *Vice President, Manager*

###### Geneva

Walter D. (Pete) Mairs, *Vice President, Manager*

###### Newark & Newark Plaza

Debra A. Murphy, *Manager*

###### Waterloo & Liberty Center Drive-thru

Gregory J. Burger, *Vice President, Manager*

### BENEFIT PLANS ADMINISTRATIVE SERVICES, INC.

1500 Genesee Street

Utica NY 13502

Girard H. Mayer, *President and CEO*

Barry S. Kublin, *Executive Vice President*