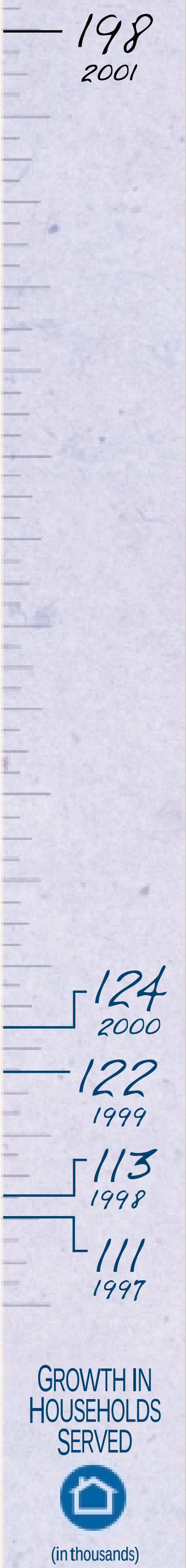
Our community is growing

Again

2001 Annual Report

COMMUNITY BANK SYSTEM, INC.



For Community Bank System, 2001 was yet another year of strong performance, fueled by a growth strategy that has proven itself to the company and its shareholders time and again. Our franchise grew on several fronts, all of which are designed to improve our long-term success, with minimal sacrifice on near-term performance. Moreover, we achieved this during a period of economic uncertainty and challenging social change. With this as a backdrop, we are happy to share with you our satisfying 2001 story. We eagerly anticipate the years to come.

Community Bank System, Inc. is a registered bank holding company based in DeWitt, N.Y., with $3.2 billion in assets. Its wholly-owned banking subsidiary, Community Bank, N.A., is the second-largest community banking franchise headquartered in Upstate New York, operating 119 customer facilities and 86 ATMs in rural and smaller urban markets throughout Northern, Central and Western New York, as well as Northeastern Pennsylvania. Other subsidiaries within the CBU family are Elias Asset Management, Inc., an investment management firm based in Williamsville, N.Y.; Benefit Plans Administrative Services, Inc. (BPA), a pension administration and consulting firm located in Utica, N.Y., serving sponsors of defined benefit and defined contribution plans; and Community Investment Services, Inc. (CISI), a broker-dealer delivering financial products, including mutual funds, annuities, individual stocks and bonds, and long-term health care and other selected insurance products, from various locations within Community Bank's branch system and from offices in Jamestown and Lockport, N.Y.

CBU LISTED NYSE

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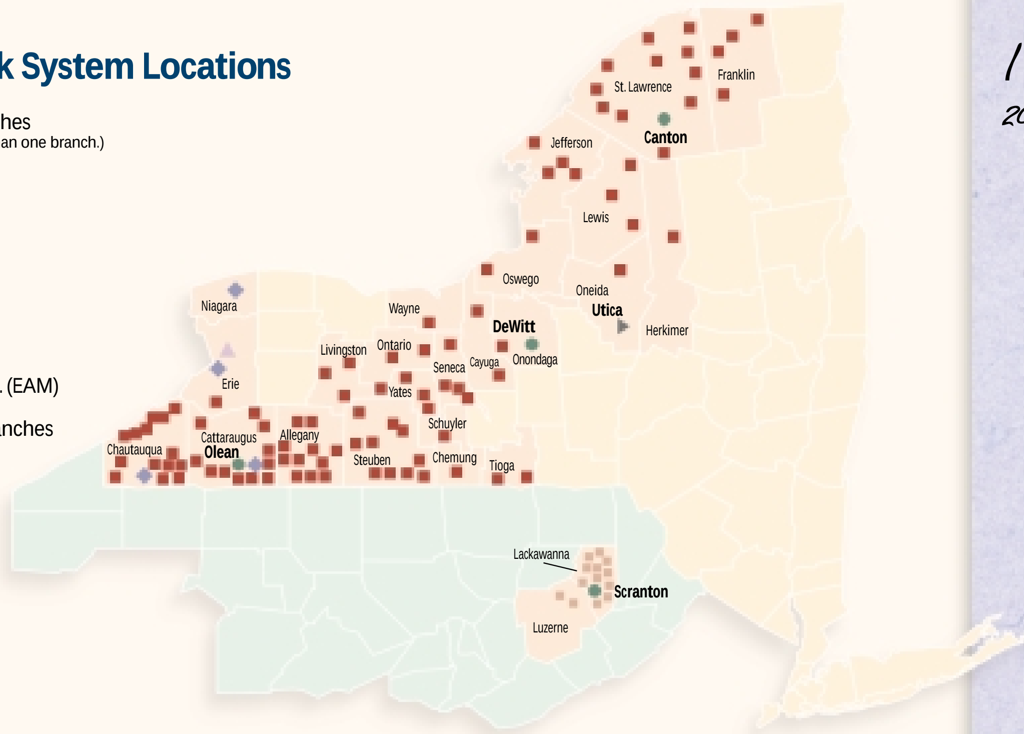
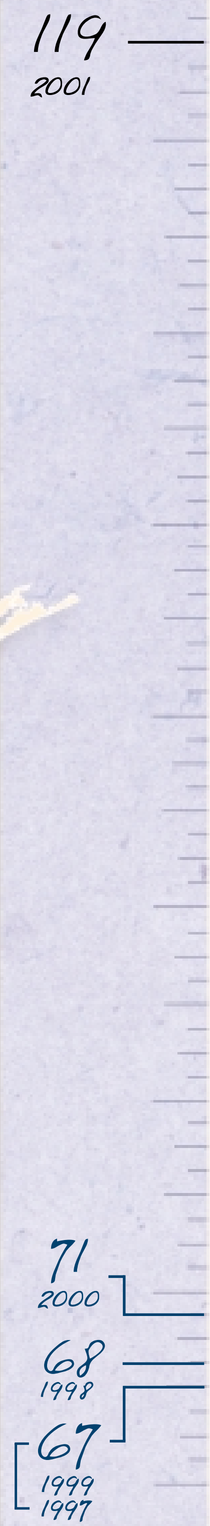
Note to Investor: Please see Glossary of Banking Terms on page 20 for explanation of certain words, phrases, and ratios used throughout this Annual Report.

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.)





GROWTH IN BRANCHES

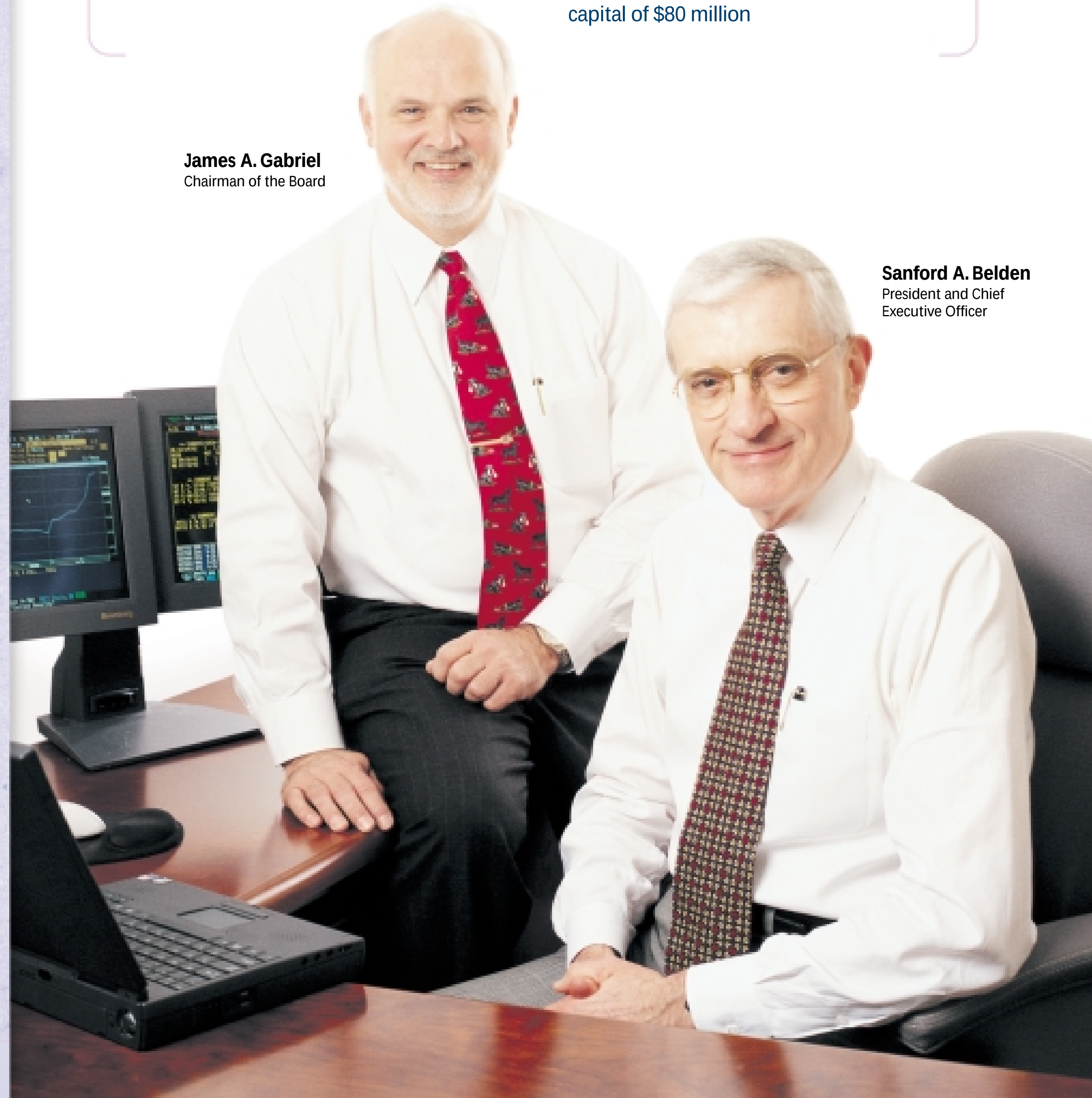
Financial Highlights

	2001	2000 (restated)	Percent Change	2000	1999	1998	1997	1996	1996-2000 5 Year CAGR
Income Statement Data (in thousands)									
Net interest income	**$96,655**	$ 90,433	6.9%	$ 71,208	$ 67,941	$ 64,395	$ 62,876	$ 55,266	8.6%
Noninterest income (excludes securities gains/losses)	**26,537**	23,284	14.0	21,201	16,125	15,081	11,822	8,842	25.9
Net income – cash operating	**28,397**	28,032	1.3	23,082	20,366	18,473	17,752	15,816	13.1
Net income – operating	**24,052**	25,136	(4.3)	20,319	17,635	15,728	15,562	14,133	12.1
Net income – cash	**23,474**	27,795	(15.5)	23,082	20,366	18,473	17,752	15,816	13.1
Net income	**19,129**	24,899	(23.2)	20,319	17,635	15,728	15,562	14,133	12.1
Weighted avg. shares outstanding	**11,825**	10,737	10.1	7,102	7,213	7,671	7,676	7,483	N/A
Common Per Share Data (Diluted)									
Net income – cash operating	**$ 2.40**	$ 2.61	(8.0)%	$ 3.23	$ 2.79	$ 2.41	$ 2.30	$ 2.05	11.8%
Net income – operating	**2.03**	2.34	(13.2)	2.85	2.42	2.05	2.02	1.83	10.9
Net income – cash	**1.99**	2.59	(23.2)	3.23	2.79	2.41	2.30	2.05	11.8
Net income	**1.62**	2.32	(30.2)	2.85	2.42	2.05	2.02	1.83	10.9
Cash dividend declared	**1.08**	1.04	3.8	1.04	0.96	0.86	0.76	0.69	10.9
Period-end book value – stated	**20.77**	19.11	8.7	19.93	15.30	16.47	15.56	14.03	8.9
Period-end book value – tangible	**9.74**	13.88	(29.8)	12.64	8.32	9.01	7.82	9.85	8.6
End of Period Balance Sheet Data (in millions)									
Total assets	**$ 3,211**	$ 2,651	21.1%	$ 2,023	$ 1,841	$ 1,681	$ 1,634	$ 1,344	11.9%
Loans, net of unearned discount	**1,733**	1,516	14.3	1,099	1,009	917	843	652	14.4
Deposits	**2,546**	1,949	30.6	1,458	1,360	1,378	1,346	1,027	7.5
Assets under management	**1,385**	1,417	(2.3)	1,282	583	337	274	196	47.3

As defined throughout this Annual Report (pages 1-20), "restated" means that the results for 2000 have been restated to include the 2001 acquisition of First Liberty Bank Corp. (FLIB) on a pooling-of-interests basis. All comparisons in the text between 2001 and 2000 are based on restated data. Unless specifically identified, all other references to 2000 and prior periods, particularly in the graphs and tables, are based on results as originally reported. Community Bank System considers this historical treatment to be an accurate reflection of its management's record of performance at the time, though this presentation is not in accordance with Generally Accepted Accounting Principles (GAAP). All historical information in Form 10-K is restated in accordance with GAAP.

2001 Performance Highlights

- Cash operating earnings reached an all-time high of $28.4 million
- Executed three acquisitions that added a net total of 49 branches, $1.0 billion in earning assets and 74,000 new households to our customer base
- Net interest income rose 6.9% to a record $96.7 million
- Noninterest income rose 14.0% to a record $26.5 million, paced by expansion of financial services
- Loans grew by 14.3%, with commercial loans increasing 11.6%, consistent with the company's strategic objectives
- Expanded the company's capital base by 32% in the last half of the year with an infusion of common and trust preferred capital of $80 million

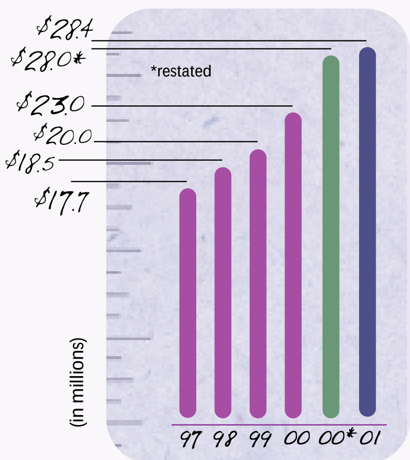


James A. Gabriel
Chairman of the Board

Sanford A. Belden
President and Chief Executive Officer

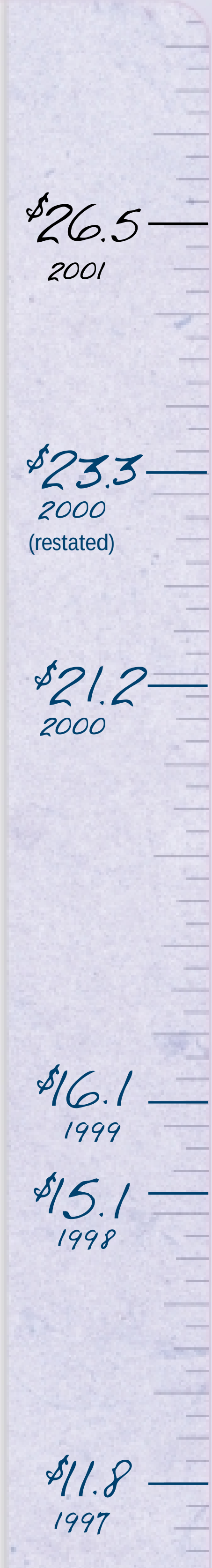
2001 represented a significant milestone in our continuing commitment to grow long-term shareholder value at CBU. Three banking acquisitions, expanded financial services revenues, greater utilization of technology, and a broader capital base represent key elements of this growth strategy.

On January 26, 2001 we successfully completed the acquisition of The Citizens National Bank of Malone, which augmented our already substantial banking presence in Northern New York. The transaction was recorded under the purchase method of accounting using an exchange of common stock, including re-issuance of treasury shares previously repurchased. This enabled us to employ pooling-of-interest basis accounting to take a second significant growth step on May 11 by acquiring First Liberty Bank Corp., based in the Scranton / Wilkes Barre area of Northeastern Pennsylvania. First Liberty is our first acquisition outside of New York State, and we are pleased to now be established in the demographically attractive markets of Northeastern Pennsylvania. The operational and other cost savings projected for both whole-bank acquisitions have been fully realized. We have successfully integrated the combined 18 branches into our distribution network and instituted sales capacity for all our financial service products in both instances.



Cash Operating Earnings

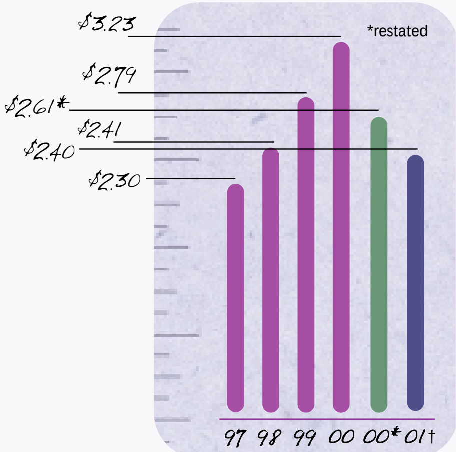
On November 16, 2001 we completed the final acquisition of 2001 by converting and assimilating 36 branches from FleetBoston with $470 million in deposits and $177 million in a mix of consumer and commercial loans. The branches are concentrated in the Finger Lakes and Western New York sections of the state, where we already enjoy significant market shares. In combination with the Citizens and First Liberty transactions, our market share will be first or second in nearly 75% of the markets where we do business as measured by deposits. Anticipated operating efficiencies have already been realized from the FleetBoston transaction, as we have completed branch consolidations in five of our markets. Our 1997 acquisition of twelve Fleet branches in Northern New York was a very positive experience, especially highlighted by revenue growth and employee skills. We are confident that our early success with this newest FleetBoston branch acquisition will continue to grow and enhance our strategy of creating a dominant branch system with decentralized decision-making.



GROWTH IN NONINTEREST INCOME

(in millions – excludes securities gains & losses)

Our strategic goal to build dominant market shares through selective acquisitions added over 74,000 households/businesses to our customer base this year, bringing CBU's total households/businesses served to 198,000. This enhanced platform for further successful cross selling supports another of our strategic focuses, that of diversifying our revenue and earnings streams through noninterest income, especially through financial services products. Elias Asset Management, acquired in April 2000, has continued to contribute very positively to earnings through challenging equity market conditions. Our personal trust business, now augmented with a Pennsylvania presence, once again produced a consistently high level of performance. We've been especially pleased with the growth and enhanced profitability of Benefit Plans Administrative Services, our pension administration and investment management business. Finally, revenue growth in our broker-dealer business was augmented by expansion into Pennsylvania and further penetration in our New York markets, which lays a foundation for increased profitability in 2002.



Cash Operating EPS

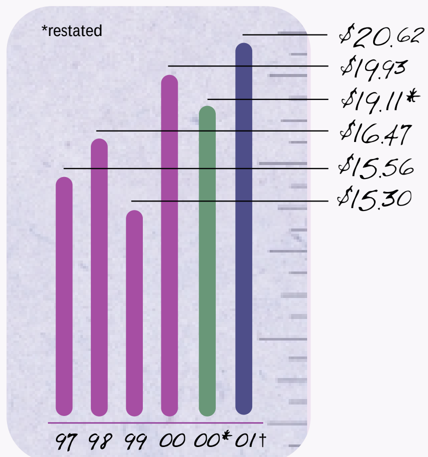
† (reflects 1.09 million greater average shares outstanding vs. restated '00)

Utilizing technology to enhance customer services and productivity is another of our growth strategies upon which we made good progress in 2001. We improved the attractiveness of our Internet banking product for retail and commercial customers by adding a bill payment feature, and we continue to offer state-of-the-art on-line services to our Benefits Plans customers. Our capability to improve operational productivity was furthered by the successful implementation of a dedicated Loan Operations Center in Olean and dedicated Deposit Operations Center in Canton, eliminating duplicate back-office and data processing functions previously performed in those locations. This area will be one of our key priorities in 2002, as we begin taking full advantage of these more focused capabilities to sharpen our customer service and more effectively control costs.

A combination of uncertain economic conditions throughout much of 2001, coupled with our dedication to asset quality, produced a year of essentially flat loan growth apart from acquisitions. Credit administration and quality have remained very solid, as measured by net charge-off and nonperforming asset ratios that are consistent with our historical performance. At the same time, we strengthened our reserves, reflecting a bottom-up assessment of our loan portfolio.

We are proud that, in the face of such a dramatic expansion of our franchise this year, cash operating earnings matched 2000's results. Nonetheless, the real impact of the acquisitions and other strategic initiatives in 2001 is the clear path they have paved toward enhanced earnings and returns to shareholders. Our net interest margin has already recovered, nicely exceeding 4% in the fourth quarter as a result of utilizing our acquired deposits to both pay off our more expensive wholesale borrowings and aggressively manage our core funding costs. Improvements in our efficiency ratio have additionally emerged, associated with operating and branch consolidations flowing from the conversions and acquisitions. Most importantly, our enhanced market share and expanded customer base provide the wherewithal for persistent top-line revenue growth.

Capital management was a significant and successful component of our 2001 accomplishments and long-term growth strategy. Approximately $49.5 million in attractively-priced, variable-rate trust preferred securities was raised in July. As a result of the Citizens and First Liberty transactions and a highly successful secondary equity offering in November, total shareholder equity nearly doubled during the year to $268 million. Correspondingly, the number of shares outstanding increased by 85%, from approximately 7.0 million (before purchase of First Liberty) to 12.9 million, leading to enhanced trading depth and liquidity in CBU stock. The secondary offering brought the added benefit of new research coverage from two well-regarded and widely-followed brokerage firms, Advest and Raymond James. Consistent with our prudent posture with respect to loan loss reserves, our tangible equity/asset ratio also increased from the inflow of equity capital, permitting more efficient and timely capital management.



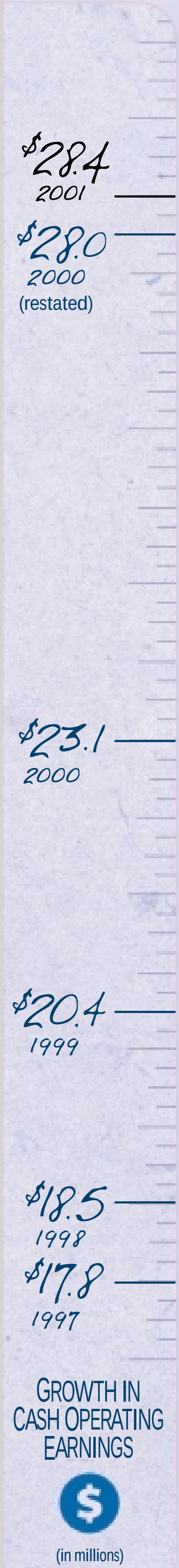
Book Value Per Share

† (reflects 2.34 million greater shares outstanding vs. restated '00)

Finally, we are pleased that returns to shareholders, including price appreciation and reinvestment of dividends, increased by over 10% during 2001 — especially in light of turbulent financial markets and the one-time expense impact of this year's dramatic expansion of our franchise. Our many achievements in 2001 reflect the insightful leadership of our Board of Directors and the exceptional hard work of countless employees throughout our company, all working to build consistent long-term value for our shareholders.

James A. Gabriel
Chairman of the Board

Sanford A. Belden
President and Chief Executive Officer



GROWTH IN FINANCIAL SERVICES INCOME

(in millions)

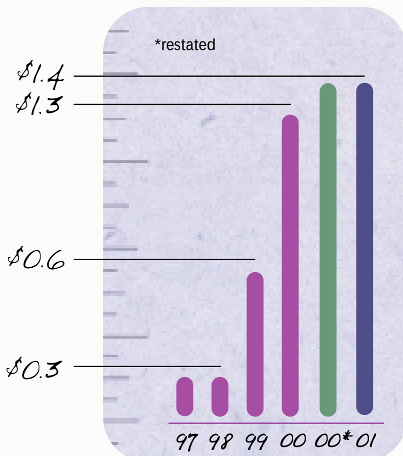
Community Banking

Community Bank, N.A. (CBNA), the second-largest community banking franchise headquartered in Upstate New York, has generated a steady pattern of controlled growth in recent years. The number of households we serve has more than doubled since 1996, and the number of branches we operate 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 67 of 91 the communities where we do business today.

Financial Services

We have been committed to growing our financial services businesses since the mid 1990s. This reduces our dependence on net interest income and diversifies our revenue sources, which helps mitigate the long-term impact of narrowing net interest margins, allowing for stronger, more consistent financial performance. Our financial services income, at $12.7 million, is over four times the level we generated just five years ago. What's more, each of our 2001 acquisitions brought us thousands of new customers, many of whom did not previously have access to such products from their prior banks. The various components of our financial services businesses performed as follows during 2001:



Assets Under Management
(in billions)

Benefit Plans Administrative Services, Inc. (BPA) — A pension administrator and consultant to small- to medium-sized businesses, BPA generated $3.9 million in revenues during 2001. This figure, a 31% increase over BPA's 2000 revenues, represented nearly 15% of our total noninterest income for 2001. BPA, based in Utica, N.Y., serves the retirement plan administration and trust needs of more than 475 plan sponsors both within and outside of CBNA's markets, and services nearly $340 million in assets.

Elias Asset Management (EAM) — Acquired in April 2000, this investment advisory firm based in Williamsville, N.Y. contributed $3.7 million to 2001 revenues. EAM has approximately $550 million in assets under management, comprised of roughly 1,150 accounts with individuals, foundations and corporate pension and profit-sharing plans. Led by President and Chief Investment Officer David J. Elias, a nationally recognized investment manager and author of two investment advice books, EAM made up 14% of our total noninterest income in 2001. David has also appeared on financial business programs such as "Wall Street Week," is a frequent guest on CNBC and CNN, and is a contributing editor to *Chief Executive* magazine.

Community Investment Services, Inc. (CISI) — In 1999, we eliminated third-party broker-dealers from the distribution process, and created our own in-house capability. CISI's mutual fund and related consumer financial sales added $2.2 million to our revenues in

2001 (over 8% of our total noninterest income), an impact that is two-thirds greater than its 1999 level. Assets held by CISI customers approximate $225 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 nearly 7% of our total noninterest income in 2001. Personal trust assets under management now exceed $300 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 related annual dividend from the underwriting agency, resulted in revenues climbing to over $1.04 million in 2001, up more than 43% from 1999's levels.

Deposit Accounts

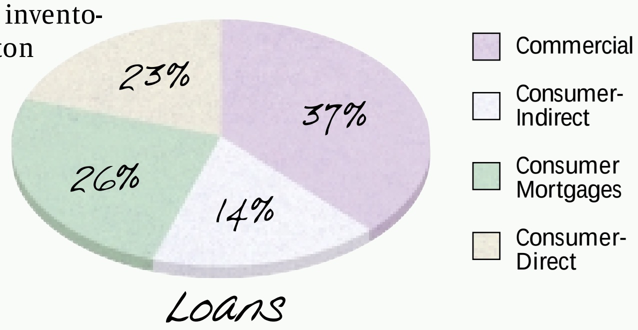
CBNA's total deposits increased 30.6% over 2000's level, and have grown at a compound annual rate of 10.9% since 1996 (75% and 19.9%, respectively, not restated for the 2001 First Liberty acquisition). In addition, in 2001 we lowered our deposit processing costs by converting our Canton, N.Y. operations facility to a deposit-only processing center, which now handles all deposits across the franchise more efficiently.

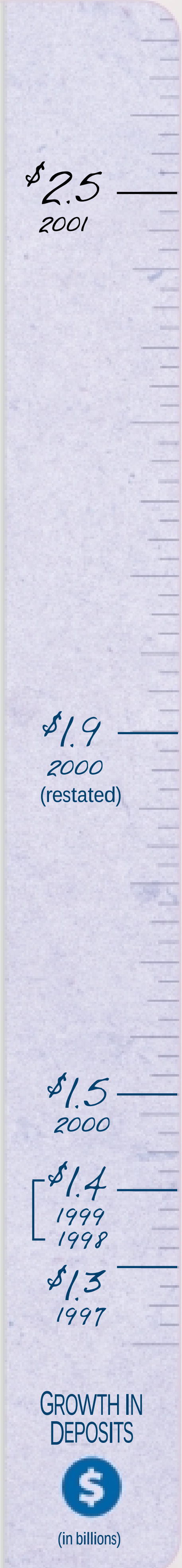
CBNA's deposit account services include standard checking, interest checking, money market, savings, time deposit and individual retirement accounts (IRAs). Individuals, partnerships, and corporations (IPC) comprise approximately 93% of our depositor base, with deposits from municipalities within our market areas making up the balance.

Lending

CBNA's predominant focus on the retail borrower results in a highly diversified loan portfolio. About 63% of CBNA's outstanding loans are provided to consumers borrowing on an installment and residential mortgage loan basis, and commercial business loans are typically for amounts under $100,000. Despite being primarily a retail bank, our business lending has increased 123% since 1997 (not restated for First Liberty), and now makes up over 37% of our total loan portfolio. Including our three acquisitions in 2001, total loans outstanding climbed 14.3%, or $217 million over 2000's level, to $1.733 billion, while business lending rose 11.6% to $644 million.

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. Like our Canton deposit facility restructuring, we converted our Olean, N.Y. operations facility to a single-purpose center in 2001, focused on processing loans more cost-effectively across the franchise.





STICKING WITH A PROVEN PLAN

Community Bank System has achieved a great deal of success in recent years by developing and remaining committed to a strategic growth strategy that consists of four key operating elements:

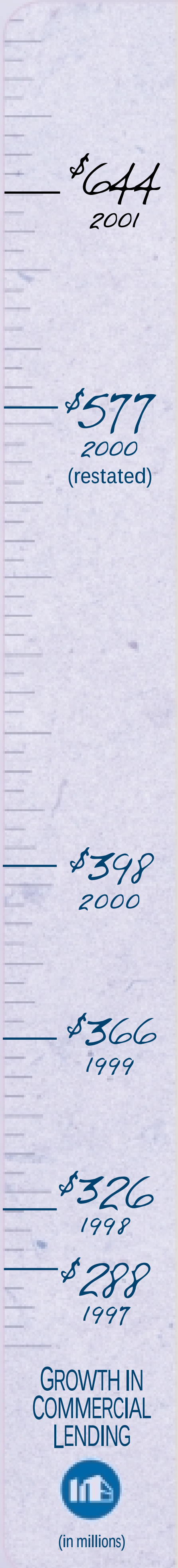
1. Create a dominant branch system that allows for decentralized, responsive decision-making at the individual branch level;
2. Diversify our revenue and earnings streams through noninterest income sources;
3. Build profitable loan volume, with an expanded focus on commercial lending; and
4. Utilize technology to enhance customer service and productivity, without diminishing our hallmark personal customer interaction.

The results of our strategy are clear, having almost doubled the size of our company between 1994-1997, and doubled it again between 1997-2001. More importantly, our cash operating earnings have risen by 175% over the seven-year period, and in the process, our shareholders have been rewarded with 9.4% annual growth in dividends per share and a total annual return of 10.5% over the last five years ended January 30, 2002.

How did we accomplish this? Years ago we recognized that the traditional community banking approach of spread lending would eventually no longer provide investors with a sufficient level of revenue and earnings growth. That prediction has come to pass in recent years. Because of this, many community banks are now searching to find alternative sources of revenue that offer better stability and margins. For many, it has been a significant challenge to make the necessary investments in people, products, and technology, leaving a merger or sale transaction as their only option. But at CBU (as we are known by our ticker symbol on the New York Stock Exchange), we have focused on strengthening our core banking business — with acquisitions when appropriate — and leveraging the expanded opportunities provided to banking institutions through recent legislation by offering a broader array of financial services.

The key to CBU's success has been an ability to determine what products make sense for our marketplace, coupled with a focus on providing these products in a practical and profitable way.

As the first element of our growth strategy states, we have purposely developed our franchise by focusing on smaller towns and villages where competition is less intense and customer loyalty can be earned through trust and outstanding service. To that end, we empower our associates at the local level to be key decision-makers, resulting in more responsive service to our customers, without sacrificing accuracy or compromising our guidelines and standards. This allows us to truly become a part of the communities we serve, and has led us to where we are today: operating 119 branches



and 86 ATMs across 24 counties in Upstate New York and Northeastern Pennsylvania. We have built upon our dominant market position to realize internal growth, which has resulted in our holding the largest or second-largest deposit market share in nearly 75% of the communities where we do business today.

The second element of our growth strategy is to diversify our revenue stream through a greater focus on noninterest income. In the mid-1990s we made a strong commitment to increase this revenue source, which mitigates the compression on our net interest margins and makes our company less susceptible to earnings volatility. We have invested significantly in obtaining the know-how and products that our customer base needs and will buy, and that investment has paid off nicely. In 1996, our noninterest income was just $8.8 million, but by the end of 2001 it was 200% greater at $26.5 million. Perhaps more importantly, our 1996 noninterest income comprised only 13.6% of our total revenue, but comprises 20.3% of our total today, demonstrating great progress toward our goal of deriving 40% of total revenue from noninterest income sources within five to ten years, which will further protect us from earnings volatility.

Financial services has been the largest and most promising area on which we have concentrated in expanding noninterest income. While we have pursued this strategy for some time, the passage of the Financial Services Modernization Act in 1999 helped clarify the set of financial products and services community banks could offer. Our complement of financial services products is now robust, including those offered through our long standing personal trust department; our broker-dealer, which primarily provides mutual fund and selected insurance products through our branches and two independent offices; our benefit plans subsidiary, which services the pension and 401(k) investment products of our corporate customers; and our asset management subsidiary, which provides wealth management services to individuals, corporations, and not-for-profits.

While we have realized opportunities to grow branch revenues and improve efficiency at the same time, revenues from financial services have grown at an even faster pace. In 1996, financial services revenues were $3.2 million, or 36% of our total noninterest income. As of 2001, they are now over 48%, at $12.7 million.

The third focal point of our growth strategy is our commitment to build a profitable and diversified loan portfolio. Our success can be measured by nearly a 12% annual rate of loan growth since 1996, while maintaining asset quality that is equal to or better than our peers.

Historically, our strategy was to seek loan growth and diversification with a primary focus on the retail borrower. However, during the past several years we have repositioned our strategy to grow our commercial business loans faster than our loans to individuals. We've hired skilled, experienced commercial lending professionals, a number of whom have left the super-regional banks within our marketplace. In line with our commitment to decentralized decision-making, we've empowered them to make loan decisions locally — a responsibility which many of them longed for during their tenures with the super-regionals. This autonomy has worked extremely well, positioning us to compete for good quality loan business. As a result, our business lending has grown from 32% to 37% of our total loans between 1996 and 2001.

During this same time period, our "direct-consumer" lending has increased modestly from 19% to 23% of total loans. These are loans issued by CBU personnel at CBU branches for a wide variety of purposes, such as automobiles, home improvement, and education, usually on an installment basis or under home equity lines of credit. Home mortgage lending, again coordinated locally through our branches, comprises a larger share of our portfolio at 26% than it did five years ago, when it represented 23%. Growth has resulted from a favorable housing market and CBU's promotion of a no-closing-cost product, which many consumers use to consolidate higher cost debt. "Indirect-consumer" lending — loans originated primarily in automobile dealer showrooms based on quick-turn-around approval from CBU's centralized buying center — now comprises a lesser weighting than in prior years, as planned, dropping from 26% in 1996 to 14% at the end of 2001.

It is difficult to imagine that any community bank can operate as a growth business without making a commitment to invest in state-of-the-art technology. Therefore, the fourth and final element in our growth strategy is an on-going commitment to have the necessary technology in place to support our growth and cost-reduction initiatives. In the past five years, we have made significant investments in technology by:

- Committing to working with a technology partner to ensure that our systems remain up-to-date and responsive to our business needs. More than nine years ago, we established a contractual relationship with Fiserv, a large data processing provider with deep expertise in the banking industry. We believe our alliance with Fiserv has provided a more economical and effective solution to meeting our technology needs, allowing us to offer expanded products and services to customers in a shorter time frame.

- Successfully introducing an Internet banking product. Thus far it has been widely accepted by more than 11,000 commercial and residential customers. We have offered on-line capability for nearly three years to 401(k) accounts serviced by our Benefit Plans Administrative Services subsidiary, and plan to bring this same service to our brokerage customers.

- Converting our check processing to an image-based system in 2000 to improve our operating efficiency and upgrade the attractiveness of our checking product. By the end of 2002, our goal is to enable customers to receive their statements via e-mail (e-statements) and, if desired, obtain their check images via the Internet. This capability complements our check safekeeping service, which has already been well received by over 37% of our customers.

- Promoting our telephone banking service (actively used by 25,000 of our customers) and our extensive network of 86 ATMs, both of which have provided enhanced convenience for our customers — and improved efficiency for us.

All told, since 1996 we have invested over $26 million in technology-related issues, both for micro computer hardware and software purchases as well as for the comprehensive services provided by Fiserv. We expect to invest another $6.9 million in 2002.

SEEKING MORE THAN BRICKS AND MORTAR

One of CBU's greatest skills has been its ability throughout the last decade to make acquisitions that both extend our market footprint and complement our product offerings.

We have reached a point where we can claim a certain amount of expertise in the acquisition process — that is, in identifying, evaluating, executing and fully integrating our acquisitions. Since 1993, we have increased our number of locations by 260%, adding 86 branches (net of closures) through a series of branch and whole-bank acquisitions. In addition, we've acquired two stand-alone financial services providers in the last five years — Benefit Plans Administrators in 1996 and Elias Asset Management in 2000 — which have become two of our most important sources of revenue growth and diversification. And we're pleased to say that our branch and financial services acquisitions have often exceeded our expectations.

How have we done this? Community Bank System has been extremely fortunate to have a management team that possesses great amounts — and varieties — of expertise within the banking and financial services industries. In fact, CBU's nine-member management team boasts a combined 244 years of banking experience, an average tenure of 27 years per member. Most of these individuals have been with CBU for at least 10 years, and many of those who are newer to the company have come to us via our acquisitions, bringing their experience in the Upstate New York/Northeastern Pennsylvania banking markets with them. And if their experience wasn't enough, by owning more than 12% of the company, it's clear our Board and management team have a significant stake in CBU's continued success.

In 2001, we resumed our branch acquisition strategy, which last added 20 branches in 1997, by making three more transactions that have created a significant platform for the company's continued growth. In January 2001, we acquired Citizens National Bank of Malone, a $111-million asset bank that added five branches on the edge of our Northern New York foot print, nicely elevating our presence there. Then, in May, we completed a much larger merger — and our first outside of New York State — with the addition of First Liberty Bank & Trust, a 13-branch franchise with $648 million in assets based in the Scranton/Wilkes-Barre, PA region. First Liberty has excellent asset quality, and as a pooling-of-interests transaction from an accounting perspective, it enhanced our capital position significantly. Together, these two transactions raised the company's asset levels nearly 40%, and capped off a 74% increase in the number of households served by CBU compared to 1996.

The strengths from these acquisitions have, in part, allowed us to continue to look for growth opportunities. So, in early June, we announced another acquisition: the purchase of 36 branches (31 after consolidations) in Western New York from FleetBoston Financial. This transaction, which closed during the fourth quarter of 2001, effectively served as a whole-bank purchase that will establish and extend our market dominance in this region, without many of the added whole-bank acquisition risks and costs. These FleetBoston branches, which we expect will be accretive to our operating earnings by third quarter 2002, raised the total number of households we serve to over 198,000.

November 2001
Acquired 36 branches from FleetBoston

May 2001
Acquired First Liberty Bank Corp. (13 branches)

January 2001
Acquired Citizens National Bank of Malone (5 branches)

April 2000
Acquired Elias Asset Management

July 1997
Acquired 12 branches from Fleet Bank

June 1997
Acquired 8 branches from Key Bank

July 1996
Acquired Benefit Plans Administrators, Inc.

July 1995
Acquired 15 branches from Chase Manhattan Bank

October 1994
Acquired 1 branch from Chase Manhattan Bank

June 1994
Acquired 3 branches from Resolution Trust Co.

1984-1988
Acquired St. Lawrence National Bank and 4 other subsidiary banks (31 branches)

April 1983
Community Bank System, Inc. is formed

ACQUISITION TIMELINE

Board of Directors

James A. Gabriel
Chairman of the Board
Owner, law firm of
Franklin & Gabriel

Sanford A. Belden
President and CEO
Community Bank System

John M. Burgess
President, Kinney Drugs
(retired)

Paul M. Cantwell, Jr.,
Owner, Cantwell & Cantwell
Law Offices

William M. Dempsey
Vice President, Rochester
Institute of Technology
(retired)

Nicholas A. DiCerbo
Partner, law firm of
DiCerbo & Palumbo

The True Value of Acquisitions

One of the substantial contributions of our financial services products is the impact they have when we make an acquisition. When we were first considering the First Liberty transaction, we recognized that, in addition to its fundamentally solid organization, impressive asset quality, and opportunity for cost savings by consolidating operations, it would also become a significant new outlet for all of our financial services products. First Liberty had barely begun offering only a few of these products, so we were inheriting a customer base that was lacking — and needed — these very products and services. Less than one year later, we are already seeing strong customer demand in this market for our financial services.

Cross-selling opportunities like these provide a key advantage to our business, and within our smaller urban and rural markets, in particular. Thus, using the recent FleetBoston transaction as an example, not only did we gain approximately $470 million in deposits and $177 million in related business and consumer loans, we also gained 40,000 new households that will now be exposed to our complete financial services portfolio, thus increasing our opportunities to gain a greater "share of wallet" among these customers.

Then there's the flip-side of our acquisitions. The term "synergy" may be among the most over-used "buzz" words in today's business world. Still, it is often one of the driving forces behind an acquisition — the idea that combined benefits can be derived beyond which each organization could achieve on its own. We've all heard companies spout of the great synergies they expect to achieve from making transactions, yet often these never come to pass.

But at CBU, we focus as much on finding cost-saving opportunities within an acquisition scenario as we do on finding new revenue-generating sources. In 2001, we completed two significant back-office consolidations by eliminating the duplicate functions at our Canton and Olean, N.Y. operations centers. The Canton center now solely processes our deposits, while the Olean facility processes all our loans. These consolidations, which included the establishment of remote item capture centers using image-based technology, enabled smooth integration of all First Liberty operations.

Combined savings from our internal consolidation, absorption of First Liberty processing, and realignment of their branch functions in accordance with our New York franchise's successful best practices, brought CBU annual savings of $3.2 million — a benefit which shareholders realized beginning in the third quarter of 2001 and will continue to earn each and every year going forward. Increased revenues have already begun to be realized from implementing our trademark local decision-making in the First Liberty branches and from offering a full range of financial services products, and are expected to make a meaningful contribution to earnings in 2002.

Focusing on the Often-Overlooked

While obtaining new loans or funding sources may be the most obvious reason for making an acquisition, one of the most valuable assets a company gains is people — the individuals who become its new employees. Unfortunately, companies often overlook this asset, and while no bank will tell you it's not "big" on customer service, at CBU, our business model depends on the skills and abilities of our employees, and the manner in which they treat our customers.

With most of our acquisitions, we have inherited employees from a company whose business models weren't working well in our type of market (which is often what sparked the sale to begin with). In every case, we've found that the major difference between their models and ours has been that their banks simply aren't designed to give customers the level of attention that CBU does, nor do they operate in a manner as decentralized and efficient as we do. So, we retrain our newfound associates after an acquisition — especially those from the super-regionals, who focus more on delivering standardized products at the lowest cost — to instill the level of customer service that we need for our company to succeed.

To that end, we have developed an intensive training program for newly acquired associates. This often becomes a form of retraining, as many of them provided good customer service at one time, before their companies were purchased and subsequently altered by super-regionals to follow a more commodity-based model. They remember what made their former banks attractive, and are anxious to adopt our service model, enhanced by the technologically-supported products that we offer.

Why Stop A Good Thing?

Disciplined acquisitions have been the cornerstone for our growth, and we anticipate that will continue to be the case. To that end, in 2001 we completed a secondary common stock offering of over 1.3 million common shares, in addition to placing nearly $50 million in floating-rate trust preferred securities. Both reduced our Federal Home Loan Bank debt levels and provided additional capital to support earning asset growth in our newly acquired markets. CBU's ability to successfully attract investors allows us the flexibility to continue evaluating constructive acquisition opportunities.

Corporate Officers (left to right): Michael A. Patton, President of Financial Services; James A. Wears, President of Banking; Sanford A. Belden, President and CEO of the Company; David G. Wallace, Treasurer of the Company; Steve R. Tokach, President of First Liberty Bank & Trust.

Board of Directors

Lee T. Hirschey
President and CEO, Climax Manufacturing Company

Harold S. Kaplan
Owner, Montage Foods

Saul Kaplan
Owner, Montage Foods

David C. Patterson
President and Owner, Wight and Patterson

Peter A. Sabia
Owner, Valley Dodge Truck Center

William N. Sloan
Vice President, The State University of New York College at Potsdam (retired)

THE ULTIMATE YARDSTICK

And what have been the fruits of our disciplined growth strategy over the last nine years, both from selected new products and the targeted acquisitions we've made?

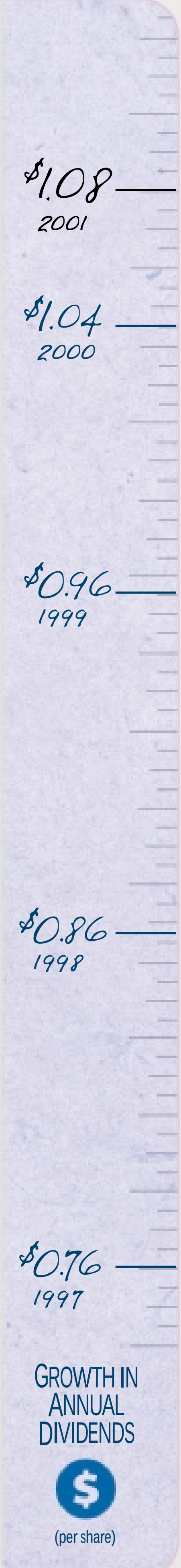
For starters, we have had consistent revenue and earnings growth, and our investor returns have regularly exceeded our peers. In addition, our company's visibility has grown along with its financial success, which has meant good things for our company, our stock price, and ultimately, our shareholders.

For the five-year period beginning in 1996 through 2000, CBU produced double-digit annual growth rates for net income (12.1%), noninterest income (25.9%), and earnings per share, both on a GAAP basis (10.9%) and a cash basis (11.8%). Cash earnings per share is a particularly important measurement for us because it recognizes that the premiums we have paid over the years for our acquisitions (which create intangible assets on our books) have value, as the success of our growth strategy amply demonstrates.

In 2001, performance was off due to several factors, including one-time expenses related to our three acquisitions, the rapid reduction in financial market interest rates (which initially narrowed our margins), and the impact of the economic recession, which began in the second quarter of the year. In addition, the management attention required to integrate the new branches and personnel into our operations and way of thinking prevented us from focusing on internal growth opportunities. This was just as well since the weak economy made monitoring the quality of our existing borrowers the more prudent course of action for the time being. The additional common shares issued to complete the financing of our series of 2001 acquisitions has also initially diluted earnings.

We are confident our growth strategy will bring significantly improved earnings in 2002. Margins have already turned up to levels in excess of those realized in 2000, our asset quality has been thoroughly reviewed in light of the recession and loss reserves conservatively established, our operating efficiency is being restored as our operations staff becomes experienced in handling the sharply expanded processing volumes that came with our acquisitions, and new business development strategies are in place to capitalize on growth opportunities as the economy begins to strengthen.

Our capital is now ample to support growth in our newly expanded markets for some time. For the 1996-2000 period, the annual growth in our dividends paid per share was 10.9%. We skipped an increase in 2001 while capital building for our acquisitions took place. Our goal is to resume our historic growth in dividends per share as earnings from our expanded franchise come on stream.



GROWTH IN ANNUAL SHARE VOLUME

And what has our growth strategy meant for our company's stock price? CBU's total annual return (including reinvestment of dividends) for the 10-year period ending January 30, 2002 was 18.9%. This compares to a median of 15.2% for our peer group (which is comprised of 25 banking institutions of our relative size in the Northeast and Ohio, operating in similar markets to our own). Our five-year return of 10.5% was less than 1% below peers, while our three-year return of 5.3% exceeded peers by almost 1%. Our dividend yield generally has been maintained in the very respectable 3.5 - 4.3% range over the last three years.

It's clear that investors have taken notice of our actions, especially recently. From a near-term share price perspective, our stock held its own in 2001, with a 10% total return — even without a dividend increase and despite the initial dilution caused by the issuance of more common shares during the fourth quarter. CBU's visibility with the investment community took a nice jump mid-way through the year with our inclusion in the Russell 3000 Index, which represents the stock market value of companies in the 2001-3000 size range. This new designation, along with our continuing efforts in the areas of investor relations, helped us generate the largest annual trading volume that CBU's stock has ever experienced — nearly five million shares.

We've also seen a rise in our total number of institutional shareholders, which has grown to 64, owning more than 3.1 million shares or 24% of CBU shares outstanding, as of December 31, 2001. This compares to 34 institutions, owning roughly 2.3 million shares, just one year ago, which is more representative of our institutional ownership figures throughout the last several years. This increase is significant because, as a company's total number of institutional investors rises, a single investor's departure often has less of an impact on that company's stock price. More importantly, the types of owners we have been attracting have shifted in many cases from short-term, high-turnover investors to more traditional, long-term investors, whose portfolio turnover tendencies are typically lower. This can often lead to less volatility in a company's stock price, but nonetheless provide desirable liquidity at times.

What's Next?

As you've just seen, we've accomplished a lot at CBU recently — not only in the past year, but over the longer-term as well. Included in those accomplishments has been tremendous planning for, and foresight into, what's to come for our company and its industry. And while no one can be certain as to what the future holds, to date we've done a very respectable job of staying ahead of the curve.

Given our solid history of growth, a clear commitment to our proven strategy, and our strong track record with making successful acquisitions, we're as confident as ever that we can keep Community Bank System growing. Again.

Glossary of Banking Terms

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 (goodwill or intangible) 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 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 reserves and the credit quality of its loan portfolio.

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

Efficiency Ratio: 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, amortization of goodwill and intangibles, gains or losses on the sale of subsidiaries, disposition of branch properties, and acquisition-related expenses. 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 provisions: The charges against earnings to provide for the write-down or charge-off of probable future defaulted loans.

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 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, excluding risk ratings on earning assets.

Shareholder Information

Corporate Headquarters

Community Bank System, Inc.
5790 Widewaters Parkway
DeWitt, NY 13214-1883
800-724-2262
Phone: 315-445-2282, Fax: 315-445-7347
www.communitybankna.com

Stock Listing

The common stock of Community Bank System, Inc. is listed on the New York Stock Exchange (NYSE) under the symbol CBU.

Its trust preferred securities are traded over the counter under the symbol CBSIP.

Newspaper listing for common stock: CmntyBkSys

Annual Meeting

Wednesday, May 15, 2002 at 1:00 p.m.
The Inn at Nichols Village
1101 Northern Boulevard
Clarks Summit, PA 18411
570-587-1135

Transfer Agent and Registrar of Stock

American Stock Transfer & Trust Company
59 Maiden Lane
New York, NY 10038
800-937-5449

Analyst Coverage

The following analysts published research about Community Bank System in 2001:

Firm and Analyst	Phone
Advest, Anthony Polini	212-484-3827
Cohen Bros. & Company, Wilson Smith	215-861-7852
Janney Montgomery Scott Claire Percarpio	215-665-4559
Keefe, Bruyette & Woods, Jared Shaw	860-246-7209
McConnell, Budd & Romano, William McCrystal	973-538-7800
Midwest Research, Peyton Green	615-734-6103

Investor Information

www.communitybankna.com

Investor and shareholder information regarding Community Bank System, Inc., including all filings with the Securities and Exchange Commission, is available through the company's web site.

Copies may also be obtained without charge upon written request to:

Ms. JosephineAnne E. Rurka
Investor Relations Department
Community Bank System, Inc.
5790 Widewaters Parkway
DeWitt, NY 13214-1883
315-445-7300
josie.rurka@communitybankna.com

Investor's Choice Program

CBSI's Investor's Choice Program offers a variety of convenient, low-cost services for investors who wish to build their share ownership.

For information, contact:
Ms. Donna J. Drengel
Shareholder Relations Department
Community Bank System, Inc.
5790 Widewaters Parkway
DeWitt, NY 13214-1883
315-445-7313
donna.drengel@communitybankna.com
or
American Stock Transfer & Trust Co.
59 Maiden Lane
New York, NY 10038
800-278-4353
www.investpower.com

Independent Accountants

The Board of Directors has appointed the firm of PricewaterhouseCoopers LLP, as auditor for the company.

The Community Bank System, Inc. Annual Report contains forward-looking statements, within the provisions of the Private Security Litigation Reform Act of 1995, that are based on current expectations, estimates, and projections about the industry, markets and economic environment in which the company operates. Such statements involve risks and uncertainties that could cause actual results to differ materially from the results discussed in these statements. These risks are detailed in the company's periodic reports filed with the Securities and Exchange Commission.

Community Bank System, Inc.

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