

I am pleased to report that our Company produced record results during the second quarter, reaching quarterly highs for both net income and earnings per share (EPS), despite a challenging yield curve environment. Our net earnings of \$14.3 million equate to a 17.6% increase over the second quarter of 2004, while the \$0.46 per share we generated were 15% greater than our year-ago mark. The first six months of 2005 were similarly strong, with net income up 18.5% over the year-earlier period, while EPS rose 15.6% to \$0.89 per share. These improvements were driven by higher earning asset levels, improved asset quality, loan growth, higher non-interest income (including securities gains), and lower acquisition expenses.

Loans climbed nearly \$45 million, or 1.9% in the second quarter, with increases achieved across all loan classes due to more aggressive business development, improved marketing initiatives and more competitive pricing strategies. This marks record quarterly production for CBU and equates to an annual growth rate of 7.6%. Our portfolio remains very well balanced, with business lending making up 34.6% of the total, while consumer mortgage and consumer installment comprise 33.8% and 31.6%, respectively. Third quarter lending is off to a good start, our pipelines remain active, and we are guardedly optimistic about our continued success in this area.

Equally important, we achieved this growth while maintaining the excellent asset quality we expect. Our non-performing loan ratio remained at the 0.56% level of a year ago – seven basis points better than the first quarter of 2005. The delinquency ratio also improved from 1.50% at June 30, 2004 to 1.32%, while our net charge-off ratio was 0.34%.

Our non-interest income (excluding securities gains) rose by 6.1% over the second quarter of 2004. In addition, our employee benefits administration and consulting business posted a 17% year-over-year revenue increase. We also continued to shorten the average life of our investment portfolio, generating a \$0.10 per share after-tax gain by selling securities that had optimized their total return and interest-rate sensitivity characteristics. As a result, we reduced the expected life-to-maturity of our portfolio from seven to five years over the last 12 months.

Our results were tempered by a slightly higher effective tax rate (26.1% vs. 25.5% a year ago), and higher recurring operating expenses, which rose 6.2%. This was due to additional expenses from First Heritage, acquired in May of last year, higher amortization of core deposit intangibles, and additional personnel and business development costs. We also experienced some start-up costs associated with a new branch and higher real estate disposal costs. Despite this, operating expenses were less than 1% above first quarter 2005's levels.

Going forward, we remain focused on our net interest margin, which decreased 33 basis points compared to a year ago, resulting in a 3.7% decrease in net interest income. The nine 25-basis-point Federal Reserve rate hikes enacted since last June have served to increase the cost of short-term borrowings and certain of our deposit products, resulting in an overall cost of funds increase of 38 basis points since the second quarter of 2004. We expect continued downward pressure on our net interest margin, which declined to 4.16% for the second quarter, for the balance of the year.

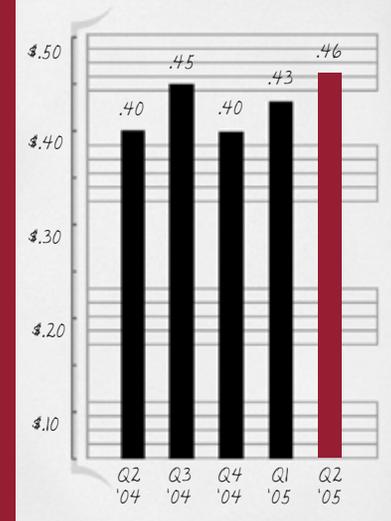
In the meantime, we continue to take steps to limit margin exposure, and evaluate opportunities to enhance our overall interest rate sensitivity profile from our securities portfolio. We're also seeking to lower operating expenses through branch efficiency measures, vendor improvement programs, and technology upgrades. And as always, we remain vigilant in seeking and evaluating acquisition opportunities that meet our strict criteria for long-term performance.

Sincerely,



Sanford A. Belden,  
President and Chief Executive Officer

Earnings Per Share (diluted)



### Financial Highlights

	Three Months Ended June 30, 2005	Six Months Ended June 30, 2005	Three Months Ended June 30, 2005	
			Change from June 30, 2004	Change from Dec. 31, 2004
<b>Income Statement Data (in thousands)</b>				
Net interest income	\$ 36,056	\$ 73,758	-3.7%	-6.5%
Noninterest income*	16,606	29,565	52.1	53.3
Net income	\$ 14,281	\$ 27,615	17.6	12.8
Dil. weighted avg. shares outstanding#	30,940	31,066	0.9%	-1.8%
<b>Common Per Share Data</b>				
Net income - diluted	\$ 0.46	\$ 0.89	15.0%	15.0%
Net income cash - diluted	0.50	0.97	16.3	13.6
Cash dividend declared	0.18	0.36	12.5	0.0
Period-end book value-stated	15.65	15.65	8.5	1.0
Period-end book value-tangible	\$ 8.09	\$ 8.09	17.6%	2.4%
<b>End of Period Balance Sheet Data (in millions)</b>				
Total assets	\$ 4,314	\$ 4,314	-1.0%	-1.8%
Loans, net of unearned discount	2,379	2,379	1.4	0.9
Deposits	2,978	2,978	1.5	1.7
Assets under management or administration	\$ 2,217	\$ 2,217	14.5%	5.5%

\*Includes net securities gains/losses. #Reflects 2-1 stock split on 4/12/04.

### Stock Performance

This table shows the high, low and closing price for CBU's common stock for each quarter.

Quarter Ending	Trade Price		Closing Price	Volume
	High	Low		
6/30/05	24.87	21.40	24.39	4,999,400
3/31/05	28.30	22.41	22.91	5,862,000
12/31/04	28.66	25.06	28.25	4,412,700
9/30/04	26.00	20.87	25.13	7,820,300
6/30/04	23.85	18.86	22.79	5,624,100

### Investor Materials

Annual and quarterly shareholder reports, regulatory filings, press releases, and articles about the Corporation which have appeared in various publications are generally available in the "Investor Services" section of our Web site, [www.communitybankna.com](http://www.communitybankna.com), or may be obtained from Ms. Josephine Anne E. Rurka by calling (315) 445-7300 or via e-mail at [josie.rurka@communitybankna.com](mailto:josie.rurka@communitybankna.com).

### Dividend Reinvestment and Stock Purchase Plan

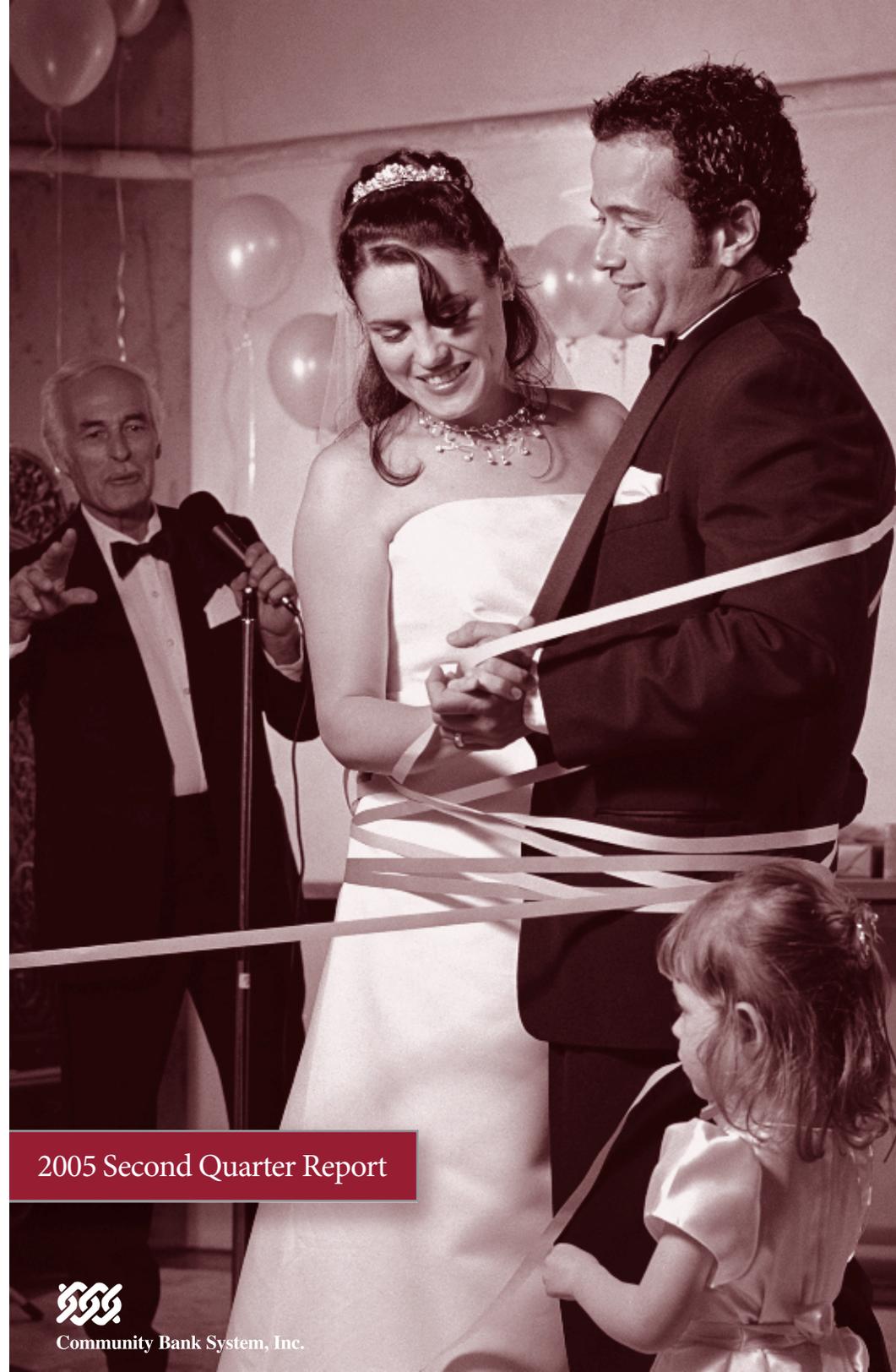
The Corporation offers its shareholders a convenient and economical plan to increase their investment in Community Bank System, Inc. common stock. This plan provides a method of investing cash dividends and voluntary cash payments in additional shares of common stock without payment of brokerage commissions or service charges. Individuals who wish to purchase CBU stock for the first time may also participate in this plan. For additional information about the plan and a prospectus, please contact either:

American Stock Transfer & Trust Company  
59 Maiden Lane  
New York, NY 10038  
[www.amstock.com](http://www.amstock.com)  
Reinvestment questions: (800) 278-4353  
General questions: (800) 937-5449

or  
Community Bank System, Inc.  
Ms. Donna J. Drengel  
Shareholder Relations Department  
(315) 445-7313  
[donna.drengel@communitybankna.com](mailto:donna.drengel@communitybankna.com)

**Community Bank System, Inc.**

5790 Widewaters Parkway • DeWitt, New York 13214-1883  
800.724.2262 • Fax 315.445.7347  
communitybankna.com



2005 Second Quarter Report



Community Bank System, Inc.