

COMMUNITY BANK SYSTEM INC  
Form 10-Q  
August 09, 2011

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

For the quarterly period ended June 30, 2011

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the transition period from \_\_\_\_\_ to \_\_\_\_\_ .

Commission File Number: 001-13695

COMMUNITY BANK SYSTEM, INC.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

16-1213679  
(I.R.S. Employer Identification No.)

5790 Widewaters Parkway, DeWitt,  
New York  
(Address of principal executive  
offices)

13214-1883  
(Zip Code)

(315) 445-2282  
(Registrant's telephone number,  
including area code)

NONE  
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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Indicate by check mark whether the registrant has submitted electronically and posted to its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (Sec.232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No .

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer  Accelerated filer  Non-accelerated filer  Smaller reporting company .

(Do not check if a smaller reporting company)

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No .

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

36,808,033 shares of Common Stock, \$1.00 par value, were outstanding on July 31, 2011.

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## Part I. Financial Information

## Item 1. Financial Statements

COMMUNITY BANK SYSTEM, INC.  
CONSOLIDATED STATEMENTS OF CONDITION (Unaudited)  
(In Thousands, Except Share Data)

	June 30, 2011	December 31, 2010
Assets:		
Cash and cash equivalents	\$273,693	\$211,837
Held-to-maturity investment securities (fair value of \$626,085 and \$625,789, respectively)	592,074	602,908
Available-for-sale investment securities (cost of \$1,401,969 and \$1,076,030, respectively)	1,440,198	1,085,963
Other securities, at cost	55,833	53,453
Loans held for sale, at fair value	869	3,952
Loans	3,478,150	3,026,363
Allowance for loan losses	(42,531)	(42,510)
Net loans	3,435,619	2,983,853
Core deposit intangibles, net	13,291	10,897
Goodwill	345,915	297,692
Other intangibles, net	3,809	3,125
Intangible assets, net	363,015	311,714
Premises and equipment, net	86,426	81,561
Accrued interest receivable	28,656	26,136
Other assets	114,102	83,129
Total assets	\$6,390,485	\$5,444,506
Liabilities:		
Noninterest-bearing deposits	\$849,071	\$741,166
Interest-bearing deposits	3,908,031	3,192,879
Total deposits	4,757,102	3,934,045
Borrowings	728,441	728,460
Subordinated debt held by unconsolidated subsidiary trusts	102,036	102,024
Accrued interest and other liabilities	72,835	72,719
Total liabilities	5,660,414	4,837,248
Commitments and contingencies (See Note J)		

## Shareholders' equity:

Preferred stock \$1.00 par value, 500,000 shares authorized, 0 shares issued	-	-
Common stock, \$1.00 par value, 50,000,000 shares authorized; 37,619,379 and 34,131,289 shares issued, respectively	37,619	34,131
Additional paid-in capital	308,779	225,543
Retained earnings	391,993	374,700
Accumulated other comprehensive income (loss)	9,456	(9,340)
Treasury stock, at cost (812,346 and 812,346 shares, respectively)	(17,776)	(17,776)
Total shareholders' equity	730,071	607,258
Total liabilities and shareholders' equity	\$6,390,485	\$5,444,506

The accompanying notes are an integral part of the consolidated financial statements.

COMMUNITY BANK SYSTEM, INC.  
CONSOLIDATED STATEMENTS OF INCOME (Unaudited)  
(In Thousands, Except Per-Share Data)

	Three Months Ended June 30, 2011		Six Months Ended June 30, 2011	
	2010	2011	2010	2011
Interest income:				
Interest and fees on loans	\$49,471	\$44,851	\$91,768	\$89,524
Interest and dividends on taxable investments	14,640	12,168	26,869	23,101
Interest and dividends on nontaxable investments	5,739	5,604	11,500	11,050
Total interest income	69,850	62,623	130,137	123,675
Interest expense:				
Interest on deposits	6,791	7,747	12,797	16,350
Interest on borrowings	7,389	7,446	14,680	15,149
Interest on subordinated debt held by unconsolidated subsidiary trusts	1,483	1,485	2,950	2,949
Total interest expense	15,663	16,678	30,427	34,448
Net interest income	54,187	45,945	99,710	89,227
Less: provision for loan losses	1,050	2,050	2,100	3,870
Net interest income after provision for loan losses	53,137	43,895	97,610	85,357
Noninterest income:				
Deposit service fees	10,488	11,337	20,173	21,856
Mortgage banking and other services	1,627	1,115	2,421	2,038
Benefit plan administration, consulting and actuarial fees	7,854	7,260	16,037	15,159
Wealth management services	2,782	2,666	4,962	5,042
Gain on investment securities & debt extinguishments, net	14	0	14	0
Total noninterest income	22,765	22,378	43,607	44,095
Operating expenses:				
Salaries and employee benefits	25,531	22,509	48,642	45,445
Occupancy and equipment	6,253	5,614	12,310	11,839
Data processing and communications	5,179	5,309	9,949	10,423
Amortization of intangible assets	1,189	1,849	2,090	3,708
Legal and professional fees	1,307	1,505	2,646	2,805
Office supplies and postage	1,377	1,311	2,573	2,560
	2,183	1,731	3,438	2,745

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Business development and marketing				
FDIC insurance premiums	1,177	1,485	2,538	3,057
Acquisition expenses	3,617	199	4,308	199
Other	3,313	2,708	5,948	5,632
Total operating expenses	51,126	44,220	94,442	88,413
Income before income taxes	24,776	22,053	46,775	41,039
Income taxes	6,790	5,891	12,629	10,875
Net income	\$17,986	\$16,162	\$34,146	\$30,164
Basic earnings per share	\$0.49	\$0.49	\$0.97	\$0.91
Diluted earnings per share	\$0.49	\$0.48	\$0.96	\$0.90
Dividends declared per share	\$0.24	\$0.24	\$0.48	\$0.46

The accompanying notes are an integral part of the consolidated financial statements.

COMMUNITY BANK SYSTEM, INC.  
CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY (Unaudited)  
Six Months Ended June 30, 2011  
(In Thousands, Except Share Data)

	Common Stock Shares Outstanding	Common Stock Amount Issued	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income(Loss)	Treasury Stock	Total
Balance at December 31, 2010	33,318,943	\$34,131	\$225,543	\$374,700	(\$9,340)	(\$17,776)	\$607,258
Net income				34,146			34,146
Other comprehensive income, net of tax					18,796		18,796
Dividends declared: Common, \$0.48 per share				(16,853)			(16,853)
Common stock issued under Stock Plan, including tax benefits of \$284	135,289	135	1,717				1,852
Stock-based compensation			2,292				2,292
Stock issued for acquisition	3,352,801	3,353	79,227				82,580
Balance at June 30, 2011	36,807,033	\$37,619	\$308,779	\$391,993	\$9,456	(\$17,776)	\$730,071

The accompanying notes are an integral part of the consolidated financial statements.



COMMUNITY BANK SYSTEM, INC.  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)  
(In Thousands)

	Three Months Ended June 30, 2011		Six Months Ended June 30, 2010	
Other comprehensive income, before tax:				
Change in pension liabilities	\$174	\$289	\$349	\$596
Change in unrealized loss on derivative instruments used in cash flow hedges	804	539	1,592	645
Unrealized gains on securities:				
Unrealized holding gains arising during period	19,425	16,689	28,402	21,052
Reclassification adjustment for gains included in net income	(106)	-	(106)	-
Other comprehensive income, before tax:	20,297	17,517	30,237	22,293
Income tax expense related to other comprehensive income	(7,620)	(6,409)	(11,441)	(8,173)
Other comprehensive income, net of tax:	12,677	11,108	18,796	14,120
Net income	17,986	16,162	34,146	30,164
Comprehensive income	\$30,663	\$27,270	\$52,942	\$44,284

The accompanying notes are an integral part of the consolidated financial statements.

COMMUNITY BANK SYSTEM, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)  
(In Thousands)

	Six Months Ended June 30,	
	2011	2010
Operating activities:		
Net income	\$34,146	\$30,164
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	5,659	4,941
Amortization of intangible assets	2,090	3,708
Net amortization (accretion) of premiums & discounts on securities, loans and borrowings	(1,431)	1,528
Stock-based compensation	2,292	2,001
Provision for loan losses	2,100	3,870
Amortization of mortgage servicing rights	446	382
Income on bank-owned life insurance policies	(374)	(280)
Gain on investment securities and debt extinguishments, net	(14)	0
Net gain on sale of loans and other assets	(524)	(246)
Net change in loans held for sale	3,538	1,005
Change in other assets and liabilities	2,464	(1,466)
Net cash provided by operating activities	50,392	45,607
Investing activities:		
Proceeds from sales of available-for-sale investment securities	10,795	0
Proceeds from maturities of held-to-maturity investment securities	18,627	42,857
Proceeds from maturities of available-for-sale investment securities	103,299	95,573
Purchases of held-to-maturity investment securities	(5,354)	(319,772)
Purchases of available-for-sale investment securities	(147,898)	(71,014)
Sales of other securities	1,195	1,060
Purchases of other securities	(2)	(8)
Net decrease in loans	10,916	5,158
Cash received from acquisition, net of cash paid of \$20,643 and \$0	6,258	0
Capital expenditures	(4,235)	(6,676)
Net cash used in investing activities	(6,399)	(252,822)
Financing activities:		
Net increase in deposits	51,503	15,489
Net decrease in borrowings	(19,779)	(25,222)
Issuance of common stock	1,852	3,063
Cash dividends paid	(15,997)	(14,479)
Excess tax benefits from stock-based compensation	284	455

Net cash provided by (used in) financing activities	17,863	(20,694)
Change in cash and cash equivalents	61,856	(227,909)
Cash and cash equivalents at beginning of period	211,837	361,876
Cash and cash equivalents at end of period	\$273,693	\$133,967
Supplemental disclosures of cash flow information:		
Cash paid for interest	\$30,134	\$34,870
Cash paid for income taxes	9,689	0
Supplemental disclosures of noncash financing and investing activities:		
Dividends declared and unpaid	8,831	7,955
Transfers from loans to other real estate	3,405	1,816
Acquisitions:		
Fair value of assets acquired, excluding acquired cash and intangibles	814,144	0
Fair value of liabilities assumed	791,222	0

The accompanying notes are an integral part of the consolidated financial statements.

COMMUNITY BANK SYSTEM, INC.  
 NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)  
 June 30, 2011

NOTE A: BASIS OF PRESENTATION

The interim financial data as of and for the three and six months ended June 30, 2011 is unaudited; however, in the opinion of Community Bank System, Inc. (the "Company"), the interim data includes all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the interim periods in accordance with generally accepted accounting principles ("GAAP"). The results of operations for the interim periods are not necessarily indicative of the results that may be expected for the full year or any other interim period. Certain prior year amounts in the consolidated financial statements and notes thereto have been reclassified to conform to the current year's presentation.

NOTE B: ACQUISITIONS

On April 8, 2011, the Company acquired The Wilber Corporation ("Wilber"), parent company of Wilber National Bank, for \$103 million in stock and cash, comprised of \$20.4 million in cash and the issuance of 3.35 million additional shares of the Company's common stock. Based in Oneonta, New York, Wilber operated 22 branches in the Central, Greater Capital District, and Catskill regions of Upstate New York.

The assets and liabilities assumed were recorded at their estimated fair values based on management's best estimates using information available at April 8, 2011, the acquisition date, and Wilber's results of operations have been included in the Company's financial statements since that date. The following table summarizes the estimated fair value of the assets acquired and liabilities assumed.

(000's omitted)	
Consideration paid:	
Community Bank System, Inc. common stock	\$82,580
Cash	20,372
Total consideration paid	102,952
Recognized amounts of identifiable assets acquired and liabilities assumed:	
Cash and cash equivalents	26,901
Investment securities	297,420
Loans	463,961
	6,213

Premises and equipment	
Accrued interest receivable	2,609
Other assets and liabilities, net	43,941
Core deposit intangibles	4,016
Other intangibles	890
Deposits	(771,554)
Borrowings	(19,668)
Total identifiable assets	54,729
Goodwill	\$ 48,223

The above recognized amounts of assets and liabilities, at fair value, are subject to adjustment based on updated information not available at the time of acquisition.

Acquired loans that have evidence of deterioration in credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments receivable were aggregated by comparable characteristics and recorded at fair value without a carryover of the related allowance for loan losses. Cash flows for each pool were determined using an estimate of future credit losses and an estimated rate of prepayments. Projected monthly cash flows were then discounted to present value using a market-based discount rate. The excess of the undiscounted expected cash flows over the estimated fair value is referred to as the “accretable yield” and is recognized into interest income over the remaining lives of the acquired loans.

The following is a summary of the loans acquired in the Wilber acquisition:

(000's omitted)	Acquired Impaired Loans	Acquired Non-Impaired Loans	Total Acquired Loans
Contractually required principal and interest at acquisition	\$37,904	\$684,460	\$722,364
Contractual cash flows not expected to be collected	(18,229)	(31,055)	(49,284)
Expected cash flows at acquisition	19,675	653,405	673,080
Interest component of expected cash flows	(2,488)	(206,662)	(209,150)
Fair value of acquired loans	\$17,187	\$446,743	\$463,930

The core deposit intangible and customer list are being amortized over their estimated useful life of approximately eight years, using an accelerated method. The goodwill, which is not amortized for book purposes, was assigned to the Banking segment and is not deductible for tax purposes.

The fair value of checking, savings and money market deposit accounts acquired from Wilber were assumed to approximate the carrying value as these accounts have no stated maturity and are payable on demand. Certificate of deposit accounts were valued as the present value of the certificates expected contracted payments discounted at market rates for similar certificates.

Direct costs related to the Wilber acquisition were expensed as incurred. During the three and six months ended June 30, 2011 the Company incurred \$3.6 million and \$4.3 million, respectively, of merger and acquisition integration related expenses and have been separately stated in the Consolidated Statements of Income.

#### Pro Forma condensed Combined Financial Information

If the Wilber acquisition had been completed on January 1, 2010, total revenue, net of interest expense would have been \$152.6 million and \$153.7 million for the six months ended June 30, 2011 and 2010, respectively and net income from continuing operations would have been \$29.7 million and \$33.0 million for the same periods. Pro forma results of operations do not include the impact of conforming certain acquiree accounting policies to the Company's policies. The pro forma financial information does not indicate the impact of possible business model changes nor does it consider any potential impacts of current market condition or revenues, expenses efficiencies, or other factors.

#### NOTE C: ACCOUNTING POLICIES

The accounting policies of the Company, as applied in the consolidated interim financial statements presented herein, are substantially the same as those followed on an annual basis as presented on pages 53 through 58 of the Annual Report on Form 10-K for the year ended December 31, 2010, with the addition of the acquired loans policy below.

#### Critical Accounting Policies

##### Acquired Loans

Acquired loans are initially recorded at their acquisition date fair values. The carryover of allowance for loan losses is prohibited as any credit losses in the loans are included in the determination of the fair value of the loans at the acquisition date. Fair values for acquired loans are based on a discounted cash flow methodology that involves assumptions and judgments as to credit risk, prepayment risk, liquidity risk, default rates, loss severity, payment

speeds, collateral values and discount rate.

Acquired loans that have evidence of deterioration in credit quality since origination and for which it is probable, at acquisition, that the Company will be unable to collect all contractually required payments receivable are aggregated by comparable characteristics. The excess of cash flows expected at acquisition over the estimated fair value is referred to as the accretable discount and is recognized into interest income over the remaining life of the loans. The difference between contractually required payments at acquisition and the cash flows expected to be collected at acquisition is referred to as the non-accretable discount. The non-accretable discount represents estimated future credit losses expected to be incurred over the life of the loan. Subsequent decreases to the expected cash flows require the Company to evaluate the need for an allowance for loan losses on these loans. Subsequent improvements in expected cash flows result in the reversal of a corresponding amount of the non-accretable discount which the Company then reclassifies as an accretable discount that is recognized into interest income over the remaining life of the loans using the interest method. The Corporation's evaluation of the amount of future cash flows that it expects to collect is performed in a similar manner as that used to determine its allowance for loan losses. Charge-offs of the principal amount on acquired loans would be first applied to the non-accretable discount portion of the fair value adjustment.

Acquired loans that met the criteria for non-accrual of interest prior to acquisition may be considered performing upon acquisition, regardless of whether the customer is contractually delinquent, if the Company can reasonably estimate the timing and amount of the expected cash flows on such loans and if the Company expects to fully collect the new carrying value of the loans. As such, the Company may no longer consider the loan to be non-accrual or non-performing and may accrue interest on these loans, including the impact of any accretable discount.

For acquired loans that are not deemed impaired at acquisition, credit discounts representing the principal losses expected over the life of the loan are a component of the initial fair value and amortized over the life of the asset. Subsequent to the purchase date, the methods utilized to estimate the required allowance for loan losses for these loans is similar to originated loans, however, the Company records a provision for loan losses only when the required allowance exceeds any remaining credit discounts.

#### Allowance for Loan Losses

Management continually evaluates the credit quality of the Company's loan portfolio, and performs a formal review of the adequacy of the allowance for loan losses on a quarterly basis. The allowance reflects management's best estimate of probable losses incurred in the loan portfolio. Determination of the allowance is subjective in nature and requires significant estimates. The Company's allowance methodology consists of two broad components - general and specific loan loss allocations.

The general loan loss allocation is composed of two calculations that are computed on five main loan segments: business lending; consumer installment – direct; consumer installment – indirect; home equity; and consumer mortgage. The first calculation determines an allowance level based on historical net charge-off data for each loan category (commercial loans exclude balances with specific loan loss allocations). The second calculation is qualitative and takes into consideration eight qualitative environmental factors: levels and trends in delinquencies and impaired loans; levels of and trends in charge-offs and recoveries; trends in volume and terms of loans; effects of any changes in risk selection and underwriting standards, and other changes in lending policies, procedure, and practices; experience, ability, and depth of lending management and other relevant staff; national and local economic trends and conditions; industry condition; and effects of changes in credit concentrations. These two calculations are added together to determine the general loan loss allocation. The specific loan loss allocation relates to individual commercial loans that are both greater than \$0.5 million and in a nonaccruing status with respect to interest. Specific losses are based on discounted estimated cash flows, including any cash flows resulting from the conversion of collateral or collateral shortfalls. The allowance levels computed from the specific and general loan loss allocation methods are combined with unallocated allowances, if any, to derive the required allowance for loan losses to be reflected on the Consolidated Statement of Condition. As it has in prior periods, the Company strives to continually refine and enhance its loss evaluation and estimation processes.

Loan losses are charged off against the allowance, while recoveries of amounts previously charged off are credited to the allowance. A provision for loan loss is charged to operations based on management's periodic evaluation of factors previously mentioned.

#### Investment Securities

The Company has classified its investments in debt and equity securities as held-to-maturity or available-for-sale. Held-to-maturity securities are those for which the Company has the positive intent and ability to hold to maturity, and are reported at cost, which is adjusted for amortization of premiums and accretion of discounts. Securities not classified as held-to-maturity are classified as available-for-sale and are reported at fair market value with net unrealized gains and losses reflected as a separate component of shareholders' equity, net of applicable income taxes. None of the Company's investment securities have been classified as trading securities at June 30, 2011. Certain equity securities are stated at cost and include restricted stock of the Federal Reserve Bank of New York and Federal Home Loan Bank of New York.

Fair values for investment securities are based upon quoted market prices, where available. If quoted market prices are not available, fair values are based upon quoted market prices of comparable instruments, or a discounted cash flow model using market estimates of interest rates and volatility. See Notes D and K for further information.

The Company conducts an assessment of all securities in an unrealized loss position to determine if other-than-temporary impairment (“OTTI”) exists on a monthly basis. An unrealized loss exists when the current fair value of an individual security is less than its amortized cost basis. The OTTI assessment considers the security structure, recent security collateral performance metrics if applicable, external credit ratings, failure of the issuer to make scheduled interest or principal payments, judgment and expectations of future performance, and relevant independent industry research, analysis and forecasts. The severity of the impairment and the length of time the security has been impaired is also considered in the assessment. The assessment of whether an OTTI decline exists is performed on each security, regardless of the classification of the security as available-for-sale or held-to-maturity and involves a high degree of subjectivity and judgment that is based on the information available to management at a point in time.

An OTTI loss must be recognized for a debt security in an unrealized loss position if there is intent to sell the security or it is more likely than not the Company will be required to sell the security prior to recovery of its amortized cost basis. In this situation, the amount of loss recognized in income is equal to the difference between the fair value and the amortized cost basis of the security. Even if it is not expected that the security will be sold, an evaluation of the expected cash flows to be received is performed to determine if a credit loss has occurred. For debt securities, a critical component of the evaluation for OTTI is the identification of credit-impaired securities, where the Company does not expect to receive cash flows sufficient to recover the entire amortized cost basis of the security. In the event of a credit loss, only the amount of impairment associated with the credit loss would be recognized in income. The portion of the unrealized loss relating to other factors, such as liquidity conditions in the market or changes in market interest rates, is recorded in “accumulated other comprehensive loss”.

Equity securities are also evaluated to determine whether the unrealized loss is expected to be recoverable based on whether evidence exists to support a realizable value equal to or greater than the amortized cost basis. If it is probable that the amortized cost basis will not be recovered, taking into consideration the estimated recovery period and the ability to hold the equity security until recovery, OTTI is recognized in earnings equal to the difference between the fair value and the amortized cost basis of the security.

The specific identification method is used in determining the realized gains and losses on sales of investment securities and other-than-temporary impairment charges. Premiums and discounts on securities are amortized and accreted, respectively, on a systematic basis over the period to maturity or estimated life of the related security. Purchases and sales of securities are recognized on a trade date basis.

#### Income Taxes

The Company and its subsidiaries file a consolidated federal income tax return. Provisions for income taxes are based on taxes currently payable or refundable as well as deferred taxes that are based on temporary differences between the tax basis of assets and liabilities and their reported amounts in the financial statements. Deferred tax assets and liabilities are reported in the financial statements at currently enacted income tax rates applicable to the period in which the deferred tax assets and liabilities are expected to be realized or settled.

Benefits from tax positions should be recognized in the financial statements only when it is more likely than not that the tax position will be sustained upon examination by the appropriate taxing authority having full knowledge of all relevant information. A tax position meeting the more-likely-than-not recognition threshold should be measured at the largest amount of benefit for which the likelihood of realization upon ultimate settlement exceeds 50 percent.

#### Intangible Assets

Intangible assets include core deposit intangibles, customer relationship intangibles and goodwill arising from acquisitions. Core deposit intangibles and customer relationship intangibles are amortized on either an accelerated or straight-line basis over periods ranging from 7 to 20 years. The initial and ongoing carrying value of goodwill and other intangible assets is based upon discounted cash flow modeling techniques that require management to make estimates regarding the amount and timing of expected future cash flows. It also requires use of a discount rate that reflects the current return requirements of the market in relation to present risk-free interest rates, required equity market premiums, and company-specific risk indicators.

The Company evaluates goodwill for impairment on an annual basis, or more often if events or circumstances indicate there may be impairment. The fair value of each reporting unit is compared to the carrying amount of that reporting unit in order to determine if impairment is indicated. If so, the fair value of the reporting units' goodwill is compared to its carrying amount and the impairment loss is measured by the excess of the carrying value over fair value.

#### Retirement Benefits

The Company provides defined benefit pension benefits to eligible employees and post-retirement health and life insurance benefits to certain eligible retirees. The Company also provides deferred compensation and supplemental executive retirement plans for selected current and former employees and officers. Expense under these plans is charged to current operations and consists of several components of net periodic benefit cost based on various actuarial assumptions regarding future experience under the plans, including discount rate, rate of future compensation increases and expected return on plan assets.

#### New Accounting Pronouncements

In June 2011, the FASB issued ASU No. 2011-05, Comprehensive Income (Topic 220) - Presentation of Comprehensive Income. This guidance eliminates the option to present the components of other comprehensive income as part of the statement of equity and requires an entity to present the total of comprehensive income, the

components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments are effective retrospectively for fiscal years, and interim periods within those years, beginning after December 15, 2011. The guidance requires changes in presentation only and will have no significant impact on the Company's Consolidated Financial Statements.

Common Fair Value Measurement and Disclosure Requirements in GAAP and International Financial Reporting Standards (IFRS). On May 12, 2011, the Financial Accounting Standards Board (FASB) and the International Accounting Standards Board both issued new guidance that results in a consistent definition of fair value and common requirements for measurement of and disclosures about fair value between GAAP and IFRS. While many of the amendments to GAAP are not expected to have a significant effect on practice, the new guidance changes some fair value measurement principles and disclosure requirements currently in GAAP. The new guidance goes into effect on January 1, 2012 for the Company and will be applied prospectively. The Company is currently evaluating the effect of the adoption of this guidance on the Company's financial condition, results of operations, or cash flows.

## NOTE D: INVESTMENT SECURITIES

The amortized cost and estimated fair value of investment securities as of June 30, 2011 and December 31, 2010 are as follows:

(000's omitted)	Amortized Cost	June 30, 2011		Estimated Fair Value	December 31, 2010			Estimated Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses		Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	
<b>Held-to-Maturity Portfolio:</b>								
U.S. Treasury and agency securities	\$478,282	\$30,307	\$0	\$508,589	\$478,100	\$21,571	\$29	\$499,642
Government agency mortgage-backed securities	43,676	2,147	0	45,823	56,891	2,753	0	59,644
Obligations of state and political subdivisions	70,074	1,898	341	71,631	67,864	277	1,691	66,450
Other securities	42	0	0	42	53	0	0	53
<b>Total held-to-maturity portfolio</b>	<b>\$592,074</b>	<b>\$34,352</b>	<b>\$341</b>	<b>\$626,085</b>	<b>\$602,908</b>	<b>\$24,601</b>	<b>\$1,720</b>	<b>\$625,789</b>
<b>Available-for-Sale Portfolio:</b>								
U.S. Treasury and agency securities	\$400,764	\$26,721	\$713	\$426,772	\$281,826	\$22,231	\$0	\$304,057
Obligations of state and political subdivisions	517,872	16,198	825	533,245	518,216	10,197	6,195	522,218
Government agency mortgage-backed securities	342,331	14,028	19	356,340	170,673	9,159	116	179,716
Pooled trust preferred securities	68,809	0	19,837	48,972	69,508	0	27,515	41,993
Corporate debt securities	19,007	1,385	0	20,392	25,523	1,634	0	27,157
Government agency collateralized mortgage obligations	52,806	1,352	153	54,005	9,904	491	0	10,395
Marketable equity securities	380	92	0	472	380	54	7	427
	<b>\$1,401,969</b>	<b>\$59,776</b>	<b>\$21,547</b>	<b>\$1,440,198</b>	<b>\$1,076,030</b>	<b>\$43,766</b>	<b>\$33,833</b>	<b>\$1,085,963</b>

Total  
available-for-sale  
portfolio

A summary of investment securities that have been in a continuous unrealized loss position for less than, or greater, than twelve months is as follows:

As of June 30, 2011

(000's omitted)	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
<b>Held-to-Maturity Portfolio:</b>						
Obligations of state and political subdivisions/						
Total held-to-maturity portfolio	\$9,743	\$341	\$0	\$0	\$9,743	\$341
<b>Available-for-Sale Portfolio:</b>						
U.S. Treasury and agency securities	40,311	713	0	0	40,311	713
Obligations of state and political subdivisions	34,185	385	4,800	440	38,985	825
Government agency mortgage-backed securities	3,920	19	0	0	3,920	19
Pooled trust preferred securities	0	0	48,972	19,837	48,972	19,837
Government agency collateralized mortgage obligations	10,148	153	0	0	10,148	153
Total available-for-sale portfolio	88,564	1,270	53,772	20,277	142,336	21,547
Total investment portfolio	\$98,307	\$1,611	\$53,772	\$20,277	\$152,079	\$21,888

As of December 31, 2010

	Less than 12 Months		12 Months or Longer		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
(000's omitted)						
<b>Held-to-Maturity Portfolio:</b>						
U.S. Treasury and agency securities	\$14,967	\$29	\$0	\$0	\$14,967	\$29
Obligations of state and political subdivisions	43,851	1,691	0	0	43,851	1,691
<b>Total held-to-maturity portfolio</b>	<b>58,818</b>	<b>1,720</b>	<b>0</b>	<b>0</b>	<b>58,818</b>	<b>1,720</b>
<b>Available-for-Sale Portfolio:</b>						
Obligations of state and political subdivisions	197,066	5,705	4,049	490	201,115	6,195
Pooled trust preferred securities	0	0	41,993	27,515	41,993	27,515
Government agency mortgage-backed securities	14,690	116	0	0	14,690	116
Marketable equity securities	210	2	11	5	221	7
<b>Total available-for-sale portfolio</b>	<b>211,966</b>	<b>5,823</b>	<b>46,053</b>	<b>28,010</b>	<b>258,019</b>	<b>33,833</b>
<b>Total investment portfolio</b>	<b>\$270,784</b>	<b>\$7,543</b>	<b>\$46,053</b>	<b>\$28,010</b>	<b>\$316,837</b>	<b>\$35,553</b>

Included in the available-for-sale portfolio are pooled trust preferred, class A-1 securities with a current total par value of \$70.4 million and unrealized losses of \$19.8 million at June 30, 2011. The underlying collateral of these assets is principally trust-preferred securities of smaller regional banks and insurance companies. The Company's securities are in the super-senior cash flow tranche of the investment pools. All other tranches in these pools will incur losses before the super senior tranche is impacted. As of June 30, 2011, an additional 34% - 37% of the underlying collateral in these securities would have to be in deferral or default concurrently to result in an expectation of non-receipt of contractual cash flows.

In determining if unrealized losses are other-than-temporary, management considers the following factors: the length of time and extent that fair value has been less than cost; the financial condition and near term prospects of the issuers; any external credit ratings; the level of excess cash flows generated from the underlying collateral supporting the principal and interest payments of the debt securities; and the level of credit enhancement provided by the structure. A detailed review of the pooled trust preferred securities was completed for the quarter ended June 30, 2011. This review included an analysis of collateral reports, a cash flow analysis, including varying degrees of projected deferral/default scenarios, and a review of various financial ratios of the underlying banks and insurance companies that make up the collateral pool. Based on the analysis performed, significant further deferral/default and further erosion in other underlying performance conditions would have to exist before the Company would incur a loss. Therefore, the Company determined an other-than-temporary impairment did not exist at June 30, 2011. To date, the Company has received all scheduled principal and interest payments and expects to fully collect all future contractual principal and interest payments. The Company does not intend to sell and it is not more likely than not that the Company will be required to sell the underlying securities. Subsequent changes in market or credit conditions could change those evaluations.

Management does not believe any individual unrealized loss as of June 30, 2011 represents an other-than-temporary impairment. The unrealized losses reported pertaining to government guaranteed mortgage-backed securities relate primarily to securities issued by GNMA, FNMA and FHLMC, who are currently rated AAA by Moody's Investor Services and Standard & Poor's and are guaranteed by the U.S. government. The obligations of state and political subdivisions are general purpose debt obligations of various states and political subdivisions. The unrealized losses in the portfolios are primarily attributable to changes in interest rates. The Company does not intend to sell these securities, nor is it more likely than not that the Company will be required to sell these securities prior to recovery of the amortized cost.

The amortized cost and estimated fair value of debt securities at June 30, 2011, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Securities not due at a single maturity date are shown separately.

(000's omitted)	Held-to-Maturity		Available-for-Sale	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	\$10,511	\$10,616	\$70,767	\$72,246
Due after one through five years	64,645	67,931	160,805	168,751
Due after five years through ten years	403,812	430,599	317,349	339,439
Due after ten years	69,430	71,116	457,531	448,945
Subtotal	548,398	580,262	1,006,452	1,029,381
Government agency collateralized mortgage obligations	0	0	52,806	54,005
Government agency mortgage-backed securities	43,676	45,823	342,331	356,340
Total	\$592,074	\$626,085	\$1,401,589	\$1,439,726

#### NOTE E: LOANS

The segments of the Company's loan portfolio are disaggregated into levels that allow management to monitor risk and performance. Consumer mortgages consist primarily of fixed rate residential instruments, typically 15 – 30 years in contractual term, secured by first liens on a property. Business lending is comprised of general purpose commercial and industrial loans including agricultural-related and dealer floor plans, as well as mortgages on commercial property. Consumer installment – indirect consists primarily of loans originated through selected dealerships and are secured by automobiles, marine and other recreational vehicles. Home equity products are consumer purpose installment loans or lines of credit most often secured by a first or second lien position on residential real estate with terms of 15 years or less. Consumer installment – direct are all other loans to consumers such as personal installment loans and lines of credit. Loans are summarized as follows:

(000's omitted)	June 30, 2011	December 31, 2010
Consumer mortgage	\$1,149,219	\$1,057,332
Business lending	1,290,893	1,023,286
Consumer installment - indirect	549,449	494,813
Home equity	330,213	305,936
Consumer installment -	158,376	144,996

direct		
Gross loans, including deferred origination costs	3,478,150	3,026,363
Allowance for loan losses	(42,531)	(42,510)
Loans, net of allowance for loan losses	\$3,435,619	\$2,983,853

The changes in the accretable discount related to the credit impaired acquired loans are as follows:

Balance at March 31, 2011	\$0
Wilber acquisition	2,489
Accretion recognized, to-date	(227)
Balance at June 30, 2011	\$2,262

## Credit Quality

Management monitors the credit quality of its loan portfolio on an ongoing basis. Measurement of delinquency and past due status are based on the contractual terms of each loan. Past due loans are reviewed on a monthly basis to identify loans for non-accrual status. The following is an aged analysis of the Company's past due loans, by class as of June 30, 2011:

(000's omitted)	30 - 89 Days	90+ Days		Total Past Due	Purchased Impaired	Current	Total Loans
		Past Due and Still Accruing	Nonaccrual				
Consumer mortgage	\$11,842	\$1,949	\$5,881	\$19,672	\$0	\$1,129,547	\$1,149,219
Business lending	7,277	157	10,928	18,362	16,520	1,256,011	1,290,893
Consumer installment - indirect	8,029	19	4	8,052	0	541,397	549,449
Home equity	2,343	273	1,020	3,636	0	326,577	330,213
Consumer installment - direct	2,343	101	0	2,444	0	155,932	158,376
Total	\$31,834	\$2,499	\$17,833	\$52,166	\$16,520	\$3,409,464	\$3,478,150

The following is an aged analysis of the Company's past due loans by class as of December 31, 2010:

(000's omitted)	30 - 89 Days	90+ Days		Total Past Due	Current	Total Loans
		Past Due and Still Accruing	Nonaccrual			
Consumer mortgage	\$16,614	\$2,308	\$4,737	\$23,659	\$1,033,673	\$1,057,332
Business lending	5,965	247	9,715	15,927	1,007,359	1,023,286
Consumer installment - indirect	10,246	131	0	10,377	484,436	494,813
Home equity	3,960	309	926	5,195	300,741	305,936
Consumer installment - direct	2,514	96	0	2,610	142,386	144,996
Total	\$39,299	\$3,091	\$15,378	\$57,768	\$2,968,595	\$3,026,363

The Company uses several credit quality indicators to assess credit risk in an ongoing manner. The Company's primary credit quality indicator for its business lending portfolio is an internal credit risk rating system that categorizes loans as "pass", "special mention", or "classified". Credit risk ratings are applied individually to those classes of loans that have significant or unique credit characteristics that benefit from a case-by-case evaluation. The following are the definitions of the Company's credit quality indicators:

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Pass	In general, the condition of the borrower and the performance of the loans are satisfactory or better.
Special Mention	In general, the condition of the borrower has deteriorated although the loan performs as agreed.
Classified	In general, the condition of the borrower has significantly deteriorated and the performance of the loan could further deteriorate if deficiencies are not corrected.

The following table shows the amount of business lending loans by credit quality category:

(000's omitted)	June 30, 2011	December 31, 2010
Pass	\$982,746	\$753,252
Special mention	172,441	159,906
Classified	119,186	110,128
Purchased impaired	16,520	0
Total	\$1,290,893	\$1,023,286

All other loans are underwritten and structured using standardized criteria and characteristics, primarily payment performance, and are normally risk rated and monitored collectively on a monthly basis. These are typically loans to individuals in the consumer categories and are delineated as either performing or nonperforming. Performing loans include current, 30 – 89 days past due and purchased impaired loans. Nonperforming loans include 90+ days past due and still accruing and non-accrual loans.

The following table details the balances in all other loan categories at June 30, 2011:

(000's omitted)	Consumer Mortgage	Indirect Consumer	Home Equity	Direct Consumer	Total
Performing	\$1,141,389	\$549,426	\$328,920	\$158,275	\$2,178,010
Nonperforming	7,830	23	1,293	101	9,247
Total	\$1,149,219	\$549,449	\$330,213	\$158,376	\$2,187,257

The following table details the balances in all other loan categories at December 31, 2010:

(000's omitted)	Consumer Mortgage	Indirect Consumer	Home Equity	Direct Consumer	Total
Performing	\$1,050,287	\$494,682	\$304,701	\$144,900	\$1,994,570
Nonperforming	7,045	131	1,235	96	8,507
<b>Total</b>	<b>\$1,057,332</b>	<b>\$494,813</b>	<b>\$305,936</b>	<b>\$144,996</b>	<b>\$2,003,077</b>

All loan classes are collectively evaluated for impairment except business lending, as described in Note B. A summary of individually evaluated impaired loans as of June 30, 2011 and December 31, 2010 follows:

(000's omitted)	June 30, 2011	December 31, 2010
Loans with reserve	\$0	\$1,465
Loans without reserve	2,564	3,846
Carrying balance	2,564	5,311
Contractual balance	3,351	7,042
Specifically allocated allowance	0	762

#### Allowance for Loan Losses

The following presents by class the activity in the allowance for loan losses:

(000's omitted)	Three Months Ended June 30, 2011						Unallocated	Total
	Consumer Mortgage	Business Lending	Home Equity	Direct Installment	Indirect Installment			
Beginning balance	\$3,099	\$21,559	\$860	\$3,794	\$9,639	\$3,196	\$42,147	
Charge-offs	(108)	(727)	(95)	(203)	(930)	0	(2,063)	
Recoveries	7	232	4	178	976	0	1,397	
Provision	288	(115)	142	109	592	34	1,050	
<b>Ending balance</b>	<b>\$3,286</b>	<b>\$20,949</b>	<b>\$911</b>	<b>\$3,878</b>	<b>\$10,277</b>	<b>\$3,230</b>	<b>\$42,531</b>	

(000's omitted)	Three Months Ended June 30, 2010						Unallocated	Total
	Consumer Mortgage	Business Lending	Home Equity	Direct Installment	Indirect Installment			
Beginning balance	\$1,290	\$23,416	\$360	\$3,681	\$9,930	\$3,418	\$42,095	
Charge-offs	(321)	(770)	(103)	(402)	(909)	0	(2,505)	
Recoveries	8	114	3	242	596	0	963	
Provision	677	859	197	241	179	(103)	2,050	
<b>Ending balance</b>	<b>\$1,654</b>	<b>\$23,619</b>	<b>\$457</b>	<b>\$3,762</b>	<b>\$9,796</b>	<b>\$3,315</b>	<b>\$42,603</b>	

Six Months Ended June 30, 2011							
(000's omitted)	Consumer Mortgage	Business Lending	Home Equity	Direct Installment	Indirect Installment	Unallocated	Total
Beginning Balance	\$2,451	\$22,326	\$689	\$3,977	\$9,922	\$3,145	\$42,510
Charge-offs	(344)	(1,570)	(131)	(620)	(1,956)	0	(4,621)
Recoveries	26	318	11	394	1,793	0	2,542
Provision	1,153	(125)	342	127	518	85	2,100
Ending Balance	\$3,286	\$20,949	\$911	\$3,878	\$10,277	\$3,230	\$42,531

Six Months Ended June 30, 2010							
(000's omitted)	Consumer Mortgage	Business Lending	Home Equity	Direct Installment	Indirect Installment	Unallocated	Total
Beginning Balance	\$1,127	\$23,577	\$374	\$3,660	\$10,004	\$3,168	\$41,910
Charge-offs	(409)	(2,138)	(103)	(828)	(1,958)	0	(5,436)
Recoveries	36	399	4	401	1,419	0	2,259
Provision	900	1,781	182	529	331	147	3,870
Ending Balance	\$1,654	\$23,619	\$457	\$3,762	\$9,796	\$3,315	\$42,603

Despite the above allocation, the allowance for loan losses is general in nature and is available to absorb losses from any loan type.

## NOTE F: GOODWILL AND IDENTIFIABLE INTANGIBLE ASSETS

The gross carrying amount and accumulated amortization for each type of identifiable intangible asset are as follows:

	As of June 30, 2011			As of December 31, 2010		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
(000's omitted)						
Amortizing intangible assets:						
Core deposit intangibles	\$64,610	(\$51,319)	\$13,291	\$60,595	(\$49,698)	\$10,897
Other intangibles	9,047	(5,238)	3,809	7,894	(4,769)	3,125
Total amortizing intangibles	\$73,657	(\$56,557)	\$17,100	\$68,489	(\$54,467)	\$14,022

The estimated aggregate amortization expense for each of the five succeeding fiscal years ended December 31 is as follows:

Jul – Dec	
2011	\$2,273
2012	3,958
2013	3,169
2014	2,464
2015	1,809
Thereafter	3,427
Total	\$17,100

Shown below are the components of the Company's goodwill at June 30, 2011:

(000's omitted)	December 31, 2010	Activity	June 30, 2011
Goodwill	\$302,516	\$48,223	\$350,739
Accumulated impairment	(4,824)	0	(4,824)
Goodwill, net	\$297,692	\$48,223	\$345,915

## NOTE G: MANDATORILY REDEEMABLE PREFERRED SECURITIES

The Company sponsors two business trusts, Community Statutory Trust III and Community Capital Trust IV ("Trust IV"), of which 100% of the common stock is owned by the Company. The trusts were formed for the purpose of issuing company-obligated mandatorily redeemable preferred securities to third-party investors and investing the proceeds from the sale of such preferred securities solely in junior subordinated debt securities of the Company. The debentures held by each trust are the sole assets of that trust. Distributions on the preferred securities issued by each trust are payable quarterly at a rate per annum equal to the interest rate being earned by the trust on the debentures held by that trust and are recorded as interest expense in the consolidated financial statements. The preferred securities are subject to mandatory redemption, in whole or in part, upon repayment of the debentures. The Company has entered into agreements which, taken collectively, fully and unconditionally guarantee the preferred securities subject to the terms of each of the guarantees. The terms of the preferred securities of each trust are as follows:

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Trust	Issuance Date	Par Amount	Interest Rate	Maturity Date	Call Provision	Call Price
III	7/31/2001	\$24.5 million	3 month LIBOR plus 3.58% (3.85%)	7/31/2031	5 year beginning 2006	101.5% declining to par at July 31, 2011
IV	12/8/2006	\$75 million	3 month LIBOR plus 1.65% (1.90%)	12/15/2036	5 year beginning 2012	Par

Upon the issuance of Trust IV, the Company entered into an interest rate swap agreement to convert the variable rate trust preferred securities into a fixed rate security for a term of five years at a fixed rate of 6.43%. Additional interest expense of approximately \$849,000 and \$1,688,000 was recognized based on the interest rate swap agreement for the three and six months ended June 30, 2011, respectively, compared to \$848,000 and \$1,696,000 for the three and six months ended June 30, 2010, respectively.

## NOTE H: BENEFIT PLANS

The Company provides a qualified defined benefit pension to qualified employees and retirees, and other post-retirement health and life insurance benefits to certain retirees, an unfunded supplemental pension plan for certain key executives, and an unfunded stock balance plan for certain of its nonemployee directors. The Company accrues for the estimated cost of these benefits through charges to expense during the years that employees earn these benefits. The net periodic benefit cost for the three and six months ended June 30 is as follows:

(000's omitted)	Pension Benefits				Post-retirement Benefits			
	Three Months		Six Months		Three Months		Six Months	
	Ended		Ended		Ended		Ended	
	June 30,		June 30,		June 30,		June 30,	
	2011	2010	2011	2010	2011	2010	2011	2010
Service cost	\$784	\$638	\$1,470	\$1,331	\$0	\$0	\$0	\$0
Interest cost	1,191	967	2,153	1,955	38	49	76	98
Expected return on plan assets	(2,167)	(1,618)	(3,934)	(3,235)	0	0	0	0
Amortization of unrecognized net loss	474	596	948	1,210	2	4	4	9
Amortization of prior service cost	(37)	(47)	(75)	(94)	(264)	(264)	(529)	(529)
Net periodic benefit cost	\$245	\$536	\$562	\$1,167	(\$224)	(\$211)	(\$449)	(\$422)

## NOTE I: EARNINGS PER SHARE

Basic earnings per share are computed based on the weighted-average common shares outstanding for the period. Diluted earnings per share are based on the weighted-average shares outstanding adjusted for the dilutive effect of restricted stock and the assumed exercise of stock options during the year. The dilutive effect of options is calculated using the treasury stock method of accounting. The treasury stock method determines the number of common shares that would be outstanding if all the dilutive options (those where the average market price is greater than the exercise price) were exercised and the proceeds were used to repurchase common shares in the open market at the average market price for the applicable time period. There were approximately 0.2 million weighted-average anti-dilutive stock options outstanding at June 30, 2011 compared to approximately 1.8 million weighted-average anti-dilutive stock options outstanding at June 30, 2010 that were not included in the computation below.

The following is a reconciliation of basic to diluted earnings per share for the three and six months ended June 30, 2011 and 2010.

(000's omitted, except per share data)	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2011	2010	2011	2010