FINANCIAL INSTITUTIONS INC
Form 10-K/A
March 19, 2004

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

FORM 10-K/A

Amendment No.1

|X| ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2003

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

Commission File Number 0-26481

[LOGO] Financial Institutions, Inc.

(Exact Name of Registrant as specified in its charter)

NEW YORK	16-0816610
(State of Incorporation)	(I.R.S. Employer Identification Number)
220 Liberty Street Warsaw, NY	14569
(Address of Principal Executive Offices)	(Zip Code)

Registrant's Telephone Number Including Area Code:
(585) 786-1100

Securities Registered Pursuant to Section 12(b) of the Act:
NONE

Securities Registered Pursuant to Section 12(g) of the Act: Title of Class:
COMMON STOCK, PAR VALUE $.01 PER SHARE

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 twelve 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 |X| NO |_|

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendments to this Form 10-K. |_|

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Act).

YES |X| NO |_|

Aggregate market value of common stock held by non-affiliates of the registrant, computed by reference to the closing price as of close of business on June 30, 2003 was $181,724,967.

As of March 1, 2004 there were issued and outstanding, exclusive of treasury

shares, 11,172,673 shares of the Registrant's Common Stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant's proxy statement to be filed with the Securities and Exchange Commission in connection with the 2004 Annual Meeting of Shareholders are incorporated by reference in Part III of this Annual Report on Form 10-K.

Explanatory Note

This Form 10-K/A is being filed solely to correct typographical errors generated during the edgarization process in Item 8 of Financial Institutions Inc.'s Annual Report on Form 10-K for the year ended December 31, 2003, filed with the Securities and Exchange Commission on March 12, 2004. Specifically, in the Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income on page 53, data in the line items associated with the purchase of preferred stock in 2001 and 2003 were inadvertently shifted to the wrong column.

The amendment conforms the Form 10-K as filed to the version that was certified by Financial Institution Inc.'s Chief Executive Officer and Chief Financial Officer, pursuant to Rules 13a-14(a) and 13a-14(b) under the Securities Exchange Act of 1934, as amended (Exchange Act). No other changes are being made by means of this filing.

FINANCIAL INSTITUTIONS, INC.

2003 ANNUAL REPORT ON FORM 10-K

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PART I

Item I. Business

Forward Looking Statements

This Annual Report on Form 10-K contains forward-looking statements, which can be identified by the use of such words as estimate, project, believe, intend, anticipate, plan, seek, expect and similar expressions. These statements are intended to identify "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 and may include:

- statements regarding our business plans, and prospects;
- statements of our goals, intentions and expectations;
- statements regarding our growth and operating strategies;
- statements regarding the quality of our loan and investment portfolios; and
- estimates of our risks and future costs and benefits.

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. In order to comply with the terms of the safe harbor, the Company notes that a variety of factors could cause the Company's actual results and experience to differ materially from the anticipated results or other expectations expressed in the Company's forward-looking statements. Some of the risks and uncertainties that may affect the operations, performance, development and results of the Company's business, the interest rate sensitivity of its assets and liabilities, and the adequacy of its allowance for loan losses, include but are not limited to the following:

- significantly increased competition among depository and other financial institutions;
- changes in the interest rate environment that reduces our margins or the fair value of financial instruments;
- general economic conditions, either nationally or in our market areas, that are worse than expected;
- declines in the value of real estate, equipment, livestock and other assets serving as collateral for our loans outstanding;
- legislative or regulatory changes that adversely affect our business;
- changes in consumer spending, borrowing and savings habits; and
- changes in accounting policies and practices, as generally accepted in the United States of America.

The Company cautions readers not to place undue reliance on any forward-looking statements, which speak only as of the date made, and advises readers that various factors, including those described above, could affect the Company's financial performance and could cause the Company's actual results or circumstances for future periods to differ materially from those anticipated or projected.

Except as required by law, the Company does not undertake, and specifically disclaims any obligation, to publicly release any revisions to any forward-looking statements to reflect the occurrence of anticipated or unanticipated events or circumstances after the date of such statements.

General

Financial Institutions, Inc. (the "Company" or "FII") is a bank holding company headquartered in Warsaw, New York, which is located 45 miles southwest of Rochester and 45 miles southeast of Buffalo. The Company operates a super-community bank holding company - a bank holding company that owns multiple community banks that are separately managed.

The Company owns four commercial banks that provide consumer, commercial and agricultural banking services in Western and Central New York State: Wyoming County Bank ("WCB"), National Bank of Geneva ("NBG"), First Tier Bank & Trust ("FTB") and Bath National Bank ("BNB"), collectively referred to as the "Banks". During 2002, the Company completed a geographic realignment of the subsidiary banks, which involved the merger of the subsidiary formerly known as The Pavilion State Bank ("PSB") into NBG and transfer of other branch offices between subsidiary banks. In September 2003 the Boards of Directors of the Company's two national bank subsidiaries, NBG and BNB entered into formal agreements with their primary regulator, the Office of the Comptroller of the Currency ("OCC"). Under the terms of the agreements, NBG and BNB, without admitting any violations agreed to take various actions to reduce the level of credit risk in the banks, including reviewing loan policies, charge-off policies for nonaccrual loans, real property appraisal standards, insider lending and overdraft policies and affiliate transactions, and adopting capital plans to ensure levels of risk-based capital at higher than minimum levels. Pursuant to these agreements, the banks have taken actions required by the agreements to ensure that their operations are in accordance with applicable laws and regulations.

The Company formerly qualified as financial holding company under the Gramm-Leach-Bliley Act (see discussion beginning on page 19), which allowed FII to expand business operations to include financial services businesses. The Company currently has two financial services subsidiaries: The FI Group, Inc. ("FIGI") and Burke Group, Inc. ("BGI"), collectively referred to as the "Financial Services Group" ("FSG"). FIGI is a brokerage subsidiary that commenced operations as a start-up company in March 2000. BGI is an employee benefits and compensation consulting firm acquired by the Company in October 2001. During 2003, the Company terminated its financial holding company status and now operates as a bank holding company. The change in status did not affect the non-financial subsidiaries or activities being conducted by the Company, although future acquisitions or expansions of non-financial activities may require prior Federal Reserve Board approval and will be limited to those that are permissible for bank holding companies.

In February 2001, the Company formed FISI Statutory Trust I ("FISI" or "Trust") (100% owned) and capitalized the trust with a $502,000 investment in FISI's

common securities. The Trust was formed to accommodate the private placement of $16.2 million in capital securities ("trust preferred securities"), the proceeds of which were utilized to partially fund the acquisition of BNB. Effective December 31, 2003, the provisions of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," resulted in the deconsolidation of the Company's wholly-owned Trust. The deconsolidation resulted in the derecognition of the $16.2 million in trust preferred securities and the recognition of $16.7 million in junior subordinated debentures and a $502,000 investment in the subsidiary trust recorded in other assets in the Company's 2003 consolidated statement of financial position.

As a super-community bank holding company, the Company's strategy has been to manage its bank subsidiaries on a decentralized basis. This strategy provides the Banks the flexibility to efficiently serve their markets and respond to local customer needs. While generally operating on a decentralized basis, the Company has consolidated selected lines of business, operations and support functions in order to achieve economies of scale, greater efficiency and operational consistency. In furtherance of this objective, in September 2002, the Company added a Credit Administration Department at the holding company to review company-wide credit policies and strengthen overall credit administration.

Available Information

This annual report, including the exhibits and schedules filed as part of the annual report, may be inspected at the public reference facility maintained by the Securities and Exchange Commission ("SEC") at its public reference room at 450 Fifth Street, NW, Washington, DC 20549 and copies of all or any part thereof may be obtained from that office upon payment of the prescribed fees. You may call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference room and you can request copies of the documents upon payment of a duplicating fee, by writing to the SEC. In addition, the SEC maintains a website that contains reports, proxy and information statements and other information regarding registrants, including us, that file electronically with the SEC which can be accessed at www.sec.gov.

The Company also makes available, free of charge through its website at www.fiiwarsaw.com, all reports filed with the SEC, including our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, as well as any amendments to those reports, as soon as reasonably practicable after those documents are filed with, or furnished to, the SEC. Information available on our website is not a part of, and should not be incorporated into, this annual report on Form 10-K.

Market Area and Competition

The Company provides a wide range of consumer and commercial banking and financial services to individuals, municipalities and businesses through a network of 48 branches and 69 ATMs in fifteen contiguous counties of Western and Central New York State: Allegany, Cattaraugus, Cayuga, Chautauqua, Chemung, Erie, Genesee, Livingston, Monroe, Ontario, Schuyler, Seneca, Steuben, Wyoming and Yates Counties.

The Company's market area is geographically and economically diversified in that it serves both rural markets and, increasingly, the larger more affluent markets of suburban Rochester and suburban Buffalo. Rochester and Buffalo are the two largest cities in New York State outside of New York City, with combined metropolitan area populations of over two million people. The Company

anticipates increasing its presence in the markets around these two cities.

The Company faces significant competition in both making loans and attracting deposits, as Western and Central New York have a high density of financial institutions. The Company's competition for loans comes principally from commercial banks, savings banks, savings and loan associations, mortgage banking companies, credit unions, insurance companies and other financial service companies. Its most direct competition for deposits has historically come from savings and loan associations, savings banks, commercial banks and credit unions. The Company faces additional competition for deposits from non-depository competitors such as the mutual fund industry, securities and brokerage firms and insurance companies.

Operating Segments

The relative asset size, profitability and average number of full-time equivalent employees ("FTEs") of the Company's operating segments as of or for the year ended December 31, 2003, are depicted in the following table:

(Dollars in thousands)

Subsidiary	Assets	Percent of Total	Net Income (Loss)	Percent of Total	Average FTEs	Perc of T
Wyoming County Bank	$ 754,639	35%	$ 9,042	63%	168	
National Bank of Geneva	721,374	33	151	1	190	
Bath National Bank	462,113	21	4,108	29	133	
First Tier Bank & Trust	225,080	11	2,117	15	67	
Financial Services Group	5,135	--	(115)	(1)	50	
Parent and eliminations, net	5,391		(1,056)	(7)	106	
Total	$2,173,732	100%	$ 14,247	100%	714	

Mergers and Acquisitions

On December 13, 2002, BNB acquired two Chemung County branch offices of BSB Bank & Trust Company of Binghamton, New York. The two offices purchased, located in Elmira and Elmira Heights, had deposit liabilities totaling $44.2 million at the time of acquisition. The acquisition was accounted for as a business combination using the purchase method of accounting, and accordingly, the excess of the purchase price over the fair value of identifiable tangible and intangible assets acquired, less liabilities assumed, of approximately $1.5 million has been recorded as goodwill. In accordance with Statement of Financial Accounting Standard (SFAS) No. 142, "Goodwill and Other Intangible Assets," the Company is not required to amortize goodwill recognized in this acquisition. The Company also recorded a $2.0 million intangible asset attributable to core deposits, which is being amortized using the straight-line method over seven years.

On May 1, 2002, FII acquired all of the common stock of the Bank of Avoca ("BOA") in exchange for 47,036 shares of FII common stock. BOA was a community bank with its main office located in Avoca, New York, as well as a branch office in Cohocton, New York. Subsequent to the acquisition, BOA was merged with BNB.

The acquisition was accounted for as a business combination using the purchase method of accounting, and accordingly, the excess of the purchase price ($1.5 million) over the fair value of identifiable tangible and intangible assets acquired ($18.4 million), less liabilities assumed ($17.3 million), of approximately $0.4 million has been recorded as goodwill. In accordance with SFAS No. 142, the Company is not required to amortize goodwill recognized in this acquisition. The Company recorded a $146,000 core deposit intangible asset, which is being amortized using the straight-line method over seven years. The results of operations for BOA are included in the income statements from the date of acquisition (May 1, 2002).

On October 22, 2001, the Company acquired the Burke Group, Inc. ("BGI"); an employee benefits administration and compensation consulting firm, with offices in Honeoye Falls and Syracuse, New York. BGI's expertise includes design and consulting for retirement and employee welfare plans, administrative services for defined contribution and benefit plans, actuarial services and post employment benefits. Under the terms of the agreement, BGI shareholders received primarily common stock as consideration for their ownership in BGI. The acquisition was accounted for as a business combination using the purchase method of accounting, and accordingly, the excess of the purchase price ($3.3 million including earned amounts and contingent amounts to date, see Note 2 of the notes to consolidated financial statements for additional discussion regarding the merger consideration) over the fair value of identifiable tangible and intangible assets acquired ($1.7 million), less liabilities assumed ($1.7 million), of approximately $3.3 million has been recorded as goodwill. In accordance with SFAS No. 142, the Company is not required to amortize goodwill recognized in this acquisition. The Company also recorded a $500,000 intangible asset for a customer list that is being amortized using the straight-line method over five years. The results of operations for BGI are included in the income statements from the date of acquisition (October 22, 2001).

On May 1, 2001, FII acquired all of the common stock of BNC, and its wholly owned subsidiary bank, BNB. BNB is a full service community bank headquartered in Bath, New York, which had 9 branch locations in Steuben, Yates, Ontario and Schuyler Counties. The Company paid $48.00 per share in cash for each of the outstanding shares of BNC common stock with an aggregate purchase price of approximately $62.6 million. The acquisition was accounted for under the purchase method of accounting, and accordingly, the excess of the purchase price ($62.6 million) over the fair value of identifiable tangible and intangible assets acquired ($295.4 million), less liabilities assumed ($269.9 million), of approximately $37.1 million has been recorded as goodwill. Goodwill was amortized in 2001 using the straight-line method over 15 years, since the transaction was consummated prior to June 30, 2001, the effective date of SFAS No. 142. However, in accordance with SFAS No. 142, the Company ceased goodwill amortization on January 1, 2002. The results of operations for BNB are included in the income statements from the date of acquisition (May 1, 2001).

Lending Activities

General. The Company, through its banking subsidiaries, offers a broad range of loans including commercial and agricultural working capital and revolving lines of credit, commercial and agricultural mortgages, equipment loans, crop and livestock loans, residential mortgage loans and home equity lines of credit, home improvement loans, student loans, automobile loans, personal loans and credit cards. Under the Company's decentralized management philosophy, each of the banks determines individually which loans are sold and which are retained for the portfolio. However, most newly originated fixed rate residential mortgage loans are sold in the secondary market. The Company retains the

servicing rights on most mortgage loans it sells and realizes monthly service fee income.

Underwriting Standards. During 2003, the Company expanded the role of the position formerly known as Chief Credit Officer to Chief Risk Officer in an effort to better manage overall corporate risk. The Credit Administration Department, which falls under the supervision of the Chief Risk Officer, was given the responsibility of reviewing company-wide credit policies with the goal of developing and implementing stronger and more standardized underwriting and credit administration policies. This process included a thorough evaluation and update of the Company's loan policy and the adoption of enhanced risk rating guidelines company-wide. The revisions to the loan policy included a focus on the Company's lending philosophy and credit objectives.

The key elements of the Company's lending philosophy include the following:

- to ensure consistent underwriting, all employees must share a common view of the risks inherent in lending to businesses as well as the standards to be applied in underwriting and managing specific credit exposures;
- pricing of credit products should be risk-based;
- the loan portfolio must be diversified to limit the potential impact of negative events; and
- careful, timely exposure monitoring through dynamic use of our risk rating system, is required to provide early warning and assure proactive management of potential problems.

The Company's credit objectives are as follows:

- service the legitimate credit needs of small businesses within target markets of our subsidiary banks;
- compete effectively as a high volume producer of credit to commercial and agricultural business within our markets;
- maintain our banks' reputations for superior quality and timely delivery of products and services to our customers;
- continue to provide competitive pricing that reflects the entire relationship and is commensurate with the risk profiles of our borrowers;
- retain, develop and acquire profitable, multi-product, value added relationships with high quality businesses;
- continue the focus on government guaranteed lending and establish a specialization in this area to meet the needs of the small businesses in our communities; and
- comply with the relevant laws and regulations.

The loan policy establishes the lending authority of individual loan officers as well as the loan authority of the banks' loan committees. The policy limits exposure to any one borrower or affiliated group of borrowers to a limit of $8,000,000 unless the amount above that number has liquid collateral pledged as security or has a U.S. Government agency guarantee. The Senior Loan Administrators and Commercial Team Leaders can approve loans up to $500,000 jointly. The subsidiary bank CEOs and Senior Loan Administrators can approve loans up to $1,000,000 jointly. Each bank has an External Loan Committee that

consists of up to three lending officers and at least two outside bank directors. The External Loan Committee may approve loans up to $2,000,000. Loans of $2,000,000 and over require the approval of

the Company's Executive Loan Committee. The Executive Loan Committee consists of the Company's CEO, the FII Chief Risk Officer (non-voting), the FII Risk Manager, the FII Loan Administration Manager, each subsidiary bank CEO, and each subsidiary bank Senior Loan Administrator.

Commercial Loans. The Company, through its banking subsidiaries, originates commercial loans in its primary market areas and underwrites them based on the borrower's ability to service the loan from operating income. The Company, through its banking subsidiaries, offers a broad range of commercial lending products, including term loans and lines of credit. Short and medium-term commercial loans, primarily collateralized, are made available to businesses for working capital (including inventory and receivables), business expansion (including acquisition of real estate, expansion and improvements) and the purchase of equipment. As a general practice, a collateral lien is placed on any available real estate, equipment or other assets owned by the borrower and a personal guarantee of the borrower is obtained. At December 31, 2003, $32 million, or 12.9%, of the aggregate commercial loan portfolio was at fixed rates while $216 million, or 87.1%, was at variable rates. The Company also utilizes government loan guarantee programs offered by the Small Business Administration (or "SBA") and Rural Economic and Community Development (or "RECD") when appropriate. See "Government Guarantee Programs" below.

Commercial Real Estate Loans. In addition to commercial loans secured by real estate, the Company, through its banking subsidiaries, makes commercial real estate loans to finance the purchase of real property which generally consists of real estate with completed structures. Commercial real estate loans are secured by first liens on the real estate, typically have variable interest rates and are amortized over a 10 to 20 year period. The underwriting analysis includes credit verification, appraisals and a review of the borrower's financial condition. At December 31, 2003, $46 million, or 12.5%, of the aggregate commercial real estate loan portfolio was at fixed rates while $324 million, or 87.5%, was at variable rates.

Agricultural Loans. Agricultural loans are offered for short-term crop production, farm equipment and livestock financing and agricultural real estate financing, including term loans and lines of credit. Short and medium-term agricultural loans, primarily collateralized, are made available for working capital (crops and livestock), business expansion (including acquisition of real estate, expansion and improvement) and the purchase of equipment. The Banks also closely monitor commodity prices and inventory build-up in various commodity categories to better anticipate price changes in key agricultural products that could adversely affect the borrowers' ability to repay their loans. At December 31, 2003 the Company had $119 million in loans to the dairy industry, which represents 8.9% of the total loan portfolio. The dairy industry is under stress from an extended period of low milk prices. The Company routinely evaluates the effect of those price changes on the cash flow of borrowers and the values of collateral supporting those loans. Borrower cash flows in the dairy industry have recently improved due to some stabilization and upward movement in milk prices. At December 31, 2003, $21 million, or 9.1%, of the agricultural loan portfolio was at fixed rates while $214 million, or 90.9%, was at variable rates. The Banks utilize government loan guarantee programs offered by the SBA and the Farm Service Agency (or "FSA") of the United States Department of Agriculture where available and appropriate. See "Government Guarantee Programs" below.

Residential Real Estate Loans. The Banks originate fixed and variable rate one-to-four family residential real estate loans collateralized by owner-occupied properties located in its market areas. A variety of real estate loan products, which generally are amortized over five to 30 years, are offered. Loans collateralized by one-to-four family residential real estate generally have been originated in amounts of no more than 80% of appraised value or have mortgage insurance. Mortgage title insurance and hazard insurance are normally required. The Company sells most newly originated fixed rate one-to-four family residential mortgages on the secondary mortgage market and retains the rights to service the mortgages. To assure maximum salability of the residential loan products for possible resale, the Company has formally adopted the underwriting, appraisal, and servicing guidelines of the Federal Home Loan Mortgage Corporation ("Freddie Mac") as part of its standard loan policy. At December 31, 2003, the residential mortgage servicing portfolio totaled $386 million, the majority of which have been sold to Freddie Mac. At December 31, 2003, $197 million, or 78.5%, of residential real estate loans retained in portfolio were at fixed rates while $54 million, or 21.5%, were at variable rates.

Consumer and Home Equity Loans. The Banks originate direct and indirect credit automobile loans, recreational vehicle loans, boat loans, home improvement loans, fixed and open-ended home equity loans, personal loans (collateralized and uncollateralized), student loans and deposit account collateralized loans. Visa cards that provide consumer credit lines are also issued. The terms of these loans typically range from 12 to 120 months and vary based upon the nature of the collateral and the size of loan. The majority of the consumer lending program is underwritten on a secured basis using the customer's home or the financed automobile, mobile home, boat or recreational vehicle as collateral. At December 31, 2003, $139 million, or 57.7%, of consumer and home equity loans were at fixed rates while $102 million, or 42.3%, were at variable rates.

Government Guarantee Programs. The Banks participate in government loan guarantee programs offered by the SBA, RECD and FSA. At December 31, 2003, the Banks had loans with an aggregate principal balance of $45.9 million that were covered by guarantees under these programs. The guarantees only cover a certain percentage of these loans. By participating in these programs, the Banks are able to broaden their base of borrowers while minimizing credit risk.

Delinquencies and Nonperforming Assets. The Banks have several procedures in place to assist in maintaining the overall quality of the Company's loan portfolio. Standardized underwriting guidelines have been established for subsidiary bank lending officers. The Company requires each bank subsidiary to report delinquencies on a monthly basis, and the Chief Risk Officer monitors these levels to identify adverse trends.

Loans are generally placed on nonaccrual status and cease accruing interest when the payment of principal or interest is delinquent for 90 days, or earlier in some cases, unless the loan is in the process of collection and the underlying collateral further supports the carrying value of the loan.

Classification of Assets. As previously indicated, the Company adopted enhanced risk rating guidelines company-wide during 2003. Risk ratings are assigned to loans in the commercial, commercial real estate and agricultural portfolios. The risk ratings are specifically used as follows:

- profile banks' risk and exposure in the loan portfolio and identify developing trends and relative levels of risk;

- guide polices which control individual exposure with regard to degree of risk;

- identify deteriorating credits which may become criticized according to regulatory definitions; and

- reflect the probability that a given customer may default on its obligations to pay in a timely fashion.

Through the underwriting and loan review process, the Banks maintain internally classified loan lists which, along with delinquency reporting, helps management assess the overall quality of the loan portfolio and the allowance for loan losses.

Loans classified as "watch" are basically satisfactory, but a higher degree of risk is evident. Loans classified as "warning" or "special mention" have potential weaknesses that may, if not corrected, weaken the loan or inadequately protect the banks' credit position.

"Substandard" loans are those with clear and well-defined weaknesses such as a higher leveraged position, unfavorable financial ratios, uncertain repayment sources or poor financial condition, which may jeopardize the full collection of the debt. Substandard loans may be placed on nonaccrual status and may have specific loss allowances assigned. Once a loan is identified as substandard, the credit relationship is assigned to the Credit Administration Department's Loan Workout Group. The Loan Workout Group performs a detailed analysis of each substandard credit, which includes evaluating the borrower's paying capacity and assessing the collateral supporting the loans outstanding. Various forms of collateral including receivables, inventory, livestock, equipment, real property and other assets, secure the majority of the substandard credits. The Loan Workout Group also quantifies credit loss exposure by determining specific loss allowances where appropriate.

Loans classified as "doubtful" have characteristics similar to substandard with the added characteristic that the weaknesses make collection or liquidation in full, on the basis of currently existing facts, conditions, and values, highly questionable and improbable. Due to the high probability of loss, nonaccrual accounting treatment is required for all assets listed as doubtful.

Assets are classified as "loss" when considered to be uncollectible and of such little value that their continuance as bankable assets is not warranted. This classification does not mean that the asset has absolutely no recovery or salvage value, but rather, that it is not practical or desirable to defer write-off even though partial recovery may be achieved in the future.

Allowance for Loan Losses. The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. The allowance reflects management's estimate of the amount of probable loan losses in the portfolio, based on the following factors:

- historical charge-off experience;

- the evaluation of the loan portfolio by the loan review function;

- levels and trends in delinquencies and non-accruals;

- trends in volume and terms;

- collateral values;
- effects of changes in lending policy;
- experience, ability and depth of management;
- national and local economic trends and conditions; and
- concentration of credit.

Subsidiary Bank management presents a quarterly review of the allowance for loan losses to each subsidiary Bank's Board of Directors as well as to the Company's Board of Directors, indicating any change in the allowance since the last review and any recommendations as to adjustments in the allowance. In order to determine the allowance for loan losses, the risk classification and delinquency status of loans and other factors are considered, such as collateral value, government guarantees, portfolio composition, trends in economic conditions and the financial strength of borrowers. Specific allowances for loans, which have been individually evaluated for impairment, are established when required. An allowance is also established for groups of loans with similar risk characteristics, based upon average historical charge-off experience taking into account levels and trends in delinquencies, loan volumes, economic and industry trends and concentrations of credit.

Investment Activities

General. The Company's investment securities policy is contained within the overall Asset-Liability Management and Investment Policy. This policy dictates that investment decisions will be made based on the safety of the investment, liquidity requirements, potential returns, cash flow targets, need for collateral and desired risk parameters. In pursuing these objectives, the Company considers the ability of an investment to provide earnings consistent with factors of quality, maturity, marketability and risk diversification. The Board of each subsidiary bank adopts an asset/liability policy containing an investment securities policy within the parameters of the Company's overall asset/liability policy. The FII Treasurer, guided by the separate ALCO Committees of each subsidiary bank, is responsible for securities portfolio decisions within the established policies.

The Company's investment securities strategy centers on providing liquidity to meet loan demand and redeeming liabilities, meeting pledging requirements, managing overall interest rate risk and maximizing portfolio yield. The Company policy generally limits security purchases to the following:

- U.S. treasury securities;
- U.S. government agency and government sponsored agency securities;
- mortgage-backed pass-through securities and collateralized mortgage obligations ("CMOs") issued by the Federal National Mortgage Association ("FNMA"), the Government National Mortgage Association ("GNMA") and Federal Home Loan Mortgage Corporation ("Freddie Mac");
- investment grade municipal securities, including tax, revenue and bond anticipation notes and general obligation and revenue notes and bonds;
- certain creditworthy un-rated securities issued by municipalities;

and investment grade corporate debt.

Additionally, the Company's investment policy limits investments in corporate bonds to no more than 10% of total investments and to bonds rated as Baa or better by Moody's Investor Services, Inc. or BBB or better by Standard & Poor's Ratings Services at the time of purchase.

Sources of Funds

General. Deposits and borrowed funds are the primary sources of the Company's funds for use in lending, investing and for other general purposes. In addition, repayments on loans, proceeds from sales of loans and securities, and cash flows from operations provide additional sources of funds.

Deposits. The Company, through its banking subsidiaries, offers a variety of deposit account products with a range of interest rates and terms. The deposit accounts consist of savings, interest-bearing checking accounts, checking accounts, money market accounts, savings, club accounts and certificates of deposit. The Company offers certificates of deposit with balances in excess of $100,000 at preferential rates (jumbo certificates) to local municipalities, businesses, and individuals as well as Individual Retirement Accounts ("IRAs") and other qualified plan accounts. To enhance its deposit product offerings, the Company provides commercial checking accounts for small to moderately sized commercial businesses, as well as a low-cost checking account service for low-income customers. The flow of deposits is influenced significantly by general economic conditions, changes in money market rates, prevailing interest rates and competition. The Banks' deposits are obtained predominantly from the areas in which the Banks' branch offices are located. The Banks rely primarily on competitive pricing of their deposit products, customer service and long-standing relationships with customers to attract and retain these deposits. On a secondary basis, the Company utilizes time deposit sales in the national brokered market ("brokered deposits") as a wholesale funding source.

Borrowed Funds. Borrowings consist mainly of advances entered into with the Federal Home Loan Bank ("FHLB"), a debt agreement with a commercial bank and sweep repurchase agreements.

Junior Subordinated Debentures Issued to Unconsolidated Subsidiary Trust. The Company formed a trust in February 2001 to accommodate the private placement of capital securities, the proceeds of which were utilized to partially fund the acquisition of BNC.

Risk Factors

Asset Quality. A significant source of risk for the Company arises from the possibility that losses will be sustained because borrowers, guarantors and related parties may fail to perform in accordance with the terms of their loans. Most loans originated by the Company are secured, but loans may be unsecured depending on the nature of the loan. With respect to secured loans, the collateral securing the repayment of these loans includes a wide variety of diverse real and personal property that may be insufficient to cover the obligations owed under such loans. Collateral values may be adversely affected by changes in prevailing economic, environmental and other conditions, including declines in the value of real estate, changes in interest rates, changes in monetary and fiscal policies of the federal government, wide-spread

disease, terrorist activity, environmental contamination and other external events. In addition, collateral appraisals that are out of date or that do not

meet M.A.I. or other recognized standards may create the impression that a loan is adequately collateralized when in fact it is not. The Company has adopted underwriting and credit monitoring procedures and policies, including the establishment and review of the allowance for loan losses and regular review of appraisals and borrower financial statements, that management believes are appropriate to mitigate the risk of loss by assessing the likelihood of nonperformance and the value of available collateral, monitoring loan performance and diversifying the Company's credit portfolio. Such policies and procedures, however, may not prevent unexpected losses that could have a material adverse effect on the Company's business, financial condition, results of operations or liquidity. See "Lending Activities" for further discussion on underwriting standards.

Interest Rate Risk. The bank industry earnings depend largely on the relationship between the yield on earning assets, primarily loans and investments, and the cost of funds, primarily deposits and borrowings. This relationship, known as the interest rate spread, is subject to fluctuation and is affected by economic and competitive factors which influence interest rates, the volume and mix of interest earning assets and interest bearing liabilities and the level of non-performing assets. Fluctuations in interest rates affect the demand of customers for the Company's products and services. The Company is subject to interest rate risk to the degree that its interest bearing liabilities reprice or mature more slowly or more rapidly or on a different basis than its interest earning assets. Significant fluctuations in interest rates could have a material adverse effect on the Company's business, financial condition, results of operations or liquidity. For additional information regarding interest rate risk, see Part II, Item 7A, "Quantitative and Qualitative Disclosures About Market Risk."

Changes in the Value of Goodwill and Other Intangible Assets. The Company had goodwill of $40.6 million and other intangible assets of $2.7 million as of December 31, 2003. Under current accounting standards, the Company is not required to amortize goodwill but rather must evaluate goodwill for impairment at least annually. If deemed impaired at any point in the future, an impairment charge representing all or a portion of goodwill will be recorded to current earnings in the period in which the impairment occurred. The capitalized value of other intangible assets is amortized to earnings over their estimated lives. Other intangible assets are also subject to periodic impairment reviews. If these assets are deemed impaired at any point in the future, an impairment charge will be recorded to current earnings in the period in which the impairment occurred. For additional information regarding goodwill and other intangible assets, see Note 6 of the notes to consolidated financial statements.

Breach of Information Security and Technology Dependence. The Company depends upon data processing, software, communication and information exchange on a variety of computing platforms and networks and over the internet. Despite instituted safeguards, the Company cannot be certain that all of its systems are entirely free from vulnerability to attack or other technological difficulties or failures. The Company relies on the services of a variety of vendors to meet its data processing and communication needs. If information security is breached or other technology difficulties or failures occur, information may be lost or misappropriated, services and operations may be interrupted and the Company could be exposed to claims from customers. Any of these results could have a material adverse effect on the Company's business, financial condition, results of operations or liquidity.

Economic Conditions, Limited Geographic Diversification. The Company's banking operations are located in Western and Central New York State. Because of the geographic concentration of its operations, the Company's results depend largely upon economic conditions in this area, which include depressed wholesale milk prices, losses of manufacturing jobs in Rochester and Buffalo, and minimal population growth throughout the region. Further deterioration in economic

conditions could adversely affect the quality of the Company's loan portfolio and the demand for its products and services, and accordingly, could have a material adverse effect on the Company's business, financial condition, results of operations or liquidity. See also "Market Area and Competition."

Ability of the Company to Execute Its Business Strategy. The financial performance and profitability of the Company will depend on its ability to execute its strategic plan and manage its future growth. Although the Company believes that it has substantially integrated recently acquired banks into the

Company's operations, there can be no assurance that unforeseen issues relating to the assimilation or prior operations of these banks, including the emergence of any material undisclosed liabilities, will not materially adversely affect the Company. In addition, the effect of the formal agreements entered into by NBG and BNB has been to increase the capital needs at those banks, and to increase staffing and loan administration expense. It is unlikely that either of these banks will be able to grow significantly through loan growth or acquisitions while the formal agreements remain in place. The Company has incurred, and may continue to incur, additional operating costs in connection with compliance with the formal agreements including, among others, incremental staff and continued higher legal, accounting and consulting expenses. Further, the reputational risk created by the formal agreements could have an impact on such matters as business generation and retention, the ability to attract and retain management at the banks, liquidity and funding. The Company's financial performance will also depend on the Company's ability to maintain profitable operations through implementing its strategic plan. Moreover, the Company's future performance is subject to a number of factors beyond its control, including when the formal agreements are lifted at BNB and NBG, pending and future federal and state banking legislation, regulatory changes, unforeseen litigation outcomes, inflation, lending and deposit rate changes, interest rate fluctuations, increased competition and economic conditions. Accordingly, these issues could have a material adverse effect on the Company's business, financial condition, results of operations or liquidity.

Dependence on Key Personnel. The Company's success depends to a significant extent on the management skills of its existing executive officers and directors, many of whom have held officer and director positions with the Company for many years. The loss or unavailability of any of its key executives or directors, including Peter G. Humphrey, Chairman of the Board of Directors, President and Chief Executive Officer, Ronald M. Miller, Senior Vice President and Chief Financial Officer, or Thomas D. Grover, Senior Vice President and Chief Risk Officer, could have a material adverse effect on the Company's business, financial condition, results of operations or liquidity. See also Part III, Item 10, "Directors and Executive Officers of Registrant."

Competition. National competitors are much larger in total assets and capitalization, have greater access to capital markets and offer a broader array of financial services than the Company. There can be no assurance that the Company will be able to compete effectively in its markets. Furthermore, developments increasing the nature or level of competition could have a material adverse effect on the Company's business, financial condition, results of operations or liquidity. See also "Market Area and Competition" and "Supervision and Regulation."

Government Regulation and Monetary Policy. The Company and the banking industry are subject to extensive regulation and supervision under federal and state laws and regulations. The restrictions imposed by such laws and regulations limit the manner in which the Company conducts its banking business, undertakes new

investments and activities and obtains financing. These regulations are designed primarily for the protection of the deposit insurance funds and consumers and not to benefit holders of the Company's securities. Financial institution regulation has been the subject of significant legislation in recent years and may be the subject of further significant legislation in the future, none of which is in the control of the Company. Significant new laws or changes in, or repeals of, existing laws could have a material adverse effect on the Company's business, financial condition, results of operations or liquidity. Further, federal monetary policy, particularly as implemented through the Federal Reserve System, significantly affects credit conditions for the Company, and any unfavorable change in these conditions could have a material adverse effect on the Company's business, financial condition, results of operations or liquidity. See also "Supervision and Regulation."

Supervision and Regulation

The supervision and regulation of financial and bank holding companies and their subsidiaries is intended primarily for the protection of depositors, the deposit insurance funds regulated by the FDIC and the banking system as a whole, and not for the protection of shareholders or creditors of bank holding companies. The various bank regulatory agencies have broad enforcement power over bank holding companies and banks, including the power to impose substantial fines, operational restrictions and other penalties for violations of laws and regulations.

The following description summarizes some of the laws to which the Company and its subsidiaries are subject. References to applicable statutes and regulations are brief summaries and do not claim to be complete. They are qualified in their entirety by reference to such statutes and regulations. Management believes the Company is in compliance in all material respects with these laws and regulations. Changes in the laws, regulations or policies that impact the Company cannot necessarily be predicted, but they may have a material effect on the business and earnings of the Company.

The Company

The Company is a bank holding company registered under the Bank Holding Company Act of 1956, as amended, and is subject to supervision, regulation and examination by the Federal Reserve Board. During 2003, the Company terminated its financial holding company status and now operates as a bank holding company. The change in status did not affect any non-financial subsidiaries or activities being conducted by the Company, although future acquisitions or expansions of non-financial activities may require prior Federal Reserve Board approval and will be limited to those that are permissible for bank holding companies. The Bank Holding Company Act and other federal laws subject bank holding companies to particular restrictions on the types of activities in which they may engage, and to a range of supervisory requirements and activities, including regulatory enforcement actions for violations of laws and regulations.

Regulatory Restrictions on Dividends; Source of Strength. It is the policy of the Federal Reserve Board that bank holding companies should pay cash dividends on common stock only out of income available over the past year, and only if prospective earnings retention is consistent with the holding company's expected future needs and financial condition. The policy provides that bank holding companies should not maintain a level of cash dividends that undermines the bank holding company's ability to serve as a source of strength to its banking subsidiaries.

Under Federal Reserve Board policy, a bank holding company is expected to act as a source of financial strength to each of its banking subsidiaries and commit resources to their support. Such support may be required at times when, absent this Federal Reserve Board policy, a holding company may not be inclined to provide it. As discussed below, a bank holding company in certain circumstances could be required to guarantee the capital plan of an undercapitalized banking subsidiary.

Safe and Sound Banking Practices. Bank holding companies are not permitted to engage in unsafe and unsound banking practices. The Federal Reserve Board's Regulation Y, for example, generally requires a holding company to give the Federal Reserve Board prior notice of any redemption or repurchase of its own equity securities, if the consideration to be paid, together with the consideration paid for any repurchases or redemptions in the preceding year, is equal to 10% or more of the company's consolidated net worth. The Federal Reserve Board may oppose the transaction if it believes that the transaction would constitute an unsafe or unsound practice or would violate any law or regulation. Depending upon the circumstances, the Federal Reserve Board could take the position that paying a dividend would constitute an unsafe or unsound banking practice.

The Federal Reserve Board has broad authority to prohibit activities of bank holding companies and their non-banking subsidiaries which represent unsafe and unsound banking practices or which constitute violations of laws or regulations, and can assess civil money penalties for certain activities conducted on a knowing and reckless basis, if those activities caused a substantial loss to a depository institution. The penalties can be as high as $1,000,000 for each day the activity continues.

Anti-Tying Restrictions. Bank holding companies and their affiliates are prohibited from tying the provision of certain services, such as extensions of credit, to other services offered by a holding company or its affiliates. In late 2002, the Federal Reserve Board adopted Regulation W, a comprehensive synthesis of prior opinions and interpretations under Sections 23A and 23B of the Federal Reserve Act. Regulation W contains an extensive discussion of tying arrangements, which could impact the way banks and bank holding companies transact business with affiliates.

Capital Adequacy Requirements. The Federal Reserve Board has adopted a system using risk-based capital guidelines to evaluate the capital adequacy of bank holding companies. Under the guidelines, specific categories of assets are assigned different risk weights, based generally on the perceived credit risk of the asset. These risk weights are multiplied by corresponding asset balances to determine a "risk-weighted" asset base. The guidelines require a minimum total risk-based capital ratio of 8.0% (of which at least 4.0% is required to consist of Tier 1 capital elements). Total capital is the sum of Tier 1 and Tier 2 capital. As of December 31, 2003, the Company's ratio of Tier 1 capital to total risk-weighted assets was 10.18% and the ratio of total capital to total risk-weighted assets was 11.44%. See "Management's Discussion and Analysis of Financial Condition and Results of Operations-Financial Condition-Capital Resources."

In addition to the risk-based capital guidelines, the Federal Reserve Board uses a leverage ratio as an additional tool to evaluate the capital adequacy of bank holding companies. The leverage ratio is a company's Tier 1 capital divided by three-month average consolidated assets. Certain highly rated bank holding companies may maintain a minimum leverage ratio of 3.0%, but other bank holding companies may be required to maintain a leverage ratio of up to 200 basis points

above the regulatory minimum. As of December 31, 2003, the Company's leverage ratio was 7.03%.

The federal banking agencies' risk-based and leverage ratios are minimum supervisory ratios generally applicable to banking organizations that meet certain specified criteria, assuming that they have the highest regulatory rating. Banking organizations not meeting these criteria are expected to operate with capital positions well above the minimum ratios. The federal bank regulatory agencies may set capital requirements for a particular banking organization that are higher than the minimum ratios when circumstances warrant. Federal Reserve Board guidelines also provide that banking organizations experiencing internal growth or making acquisitions will be expected to maintain strong capital positions substantially above the minimum supervisory levels, without significant reliance on intangible assets.

Imposition of Liability for Undercapitalized Subsidiaries. Bank regulators are required to take "prompt corrective action" to resolve problems associated with insured depository institutions whose capital declines below certain levels. In the event an institution becomes "undercapitalized," it must submit a capital restoration plan. The capital restoration plan will not be accepted by the regulators unless each company having control of the undercapitalized institution guarantees the subsidiary's compliance with the capital restoration plan up to a certain specified amount. Any such guarantee from a depository institutions holding company is entitled to a priority of payment in bankruptcy.

The aggregate liability of the holding company of an undercapitalized bank is limited to the lesser of 5% of the institution's assets at the time it became undercapitalized or the amount necessary to cause the institution to be "adequately capitalized." The bank regulators have greater power in situations where an institution becomes "significantly" or "critically" undercapitalized or fails to submit a capital restoration plan. For example, a bank holding company controlling such an institution can be required to obtain prior Federal Reserve Board approval of proposed dividends, or might be required to consent to a consolidation or to divest the troubled institution or other affiliates.

Acquisitions by Bank Holding Companies. The Bank Holding Company Act requires every bank holding company to obtain the prior approval of the Federal Reserve Board before it may acquire all or substantially all of the assets of any bank, or ownership or control of any voting shares of any bank, if after such acquisition it would own or control, directly or indirectly, more than 5% of the voting shares of such bank. In approving bank acquisitions by bank holding companies, the Federal Reserve Board is required to consider the financial and managerial resources and future prospects of the bank holding company and the banks concerned, the convenience and needs of the communities to be served, and various competitive factors.

Control Acquisitions. The Change in Bank Control Act prohibits a person or group of persons from acquiring "control" of a bank holding company unless the Federal Reserve Board has been notified and has not objected to the transaction. Under a rebuttable presumption established by the Federal Reserve Board, the acquisition of 10% or more of a class of voting stock of a bank holding company with a class of

securities registered under Section 12 of the Exchange Act, would, under the circumstances set forth in the presumption, constitute acquisition of control of the Company.

In addition, any entity is required to obtain the approval of the Federal

Reserve Board under the Bank Holding Company Act before acquiring 25% (5% in the case of an acquirer that is a bank holding company) or more of the Company's outstanding common stock, or otherwise obtaining control or a "controlling influence" over the Company.

The Banks

Wyoming County Bank ("WCB") and First Tier Bank & Trust ("FTB") are New York State-chartered banks. National Bank of Geneva ("NBG") and Bath National Bank ("BNB") are national banks chartered by the Office of the Comptroller of Currency. The FDIC through the Bank Insurance Fund insures all of the deposits of the four subsidiary banks. FTB is a member of the Federal Reserve System. The Banks are subject to supervision and regulation that subject them to special restrictions, requirements, potential enforcement actions and periodic examination by the FDIC, the Federal Reserve Board and the New York State Banking Department (in the case of the state-chartered banks) and the Office of the Comptroller of Currency (in the case of the national banks). Because the Federal Reserve Board regulates the bank holding company parent of the Banks, the Federal Reserve Board also has supervisory authority, which directly affects the banks.

Restrictions on Transactions with Affiliates and Insiders. Transactions between the holding company and its subsidiaries, including the Banks, are subject to Section 23A of the Federal Reserve Act, and to the requirements of Regulation W. In general, Section 23A imposes limits on the amount of such transactions, and also requires certain levels of collateral for loans to affiliated parties. It also limits the amount of advances to third parties, which are collateralized by the securities, or obligations of the Company or its subsidiaries.

Affiliate transactions are also subject to Section 23B of the Federal Reserve Act, and to the requirements of Regulation W which generally requires that certain transactions between the holding company and its affiliates be on terms substantially the same, or at least as favorable to the banks, as those prevailing at the time for comparable transactions with or involving other nonaffiliated persons.

The restrictions on loans to directors, executive officers, principal shareholders and their related interests (collectively referred to herein as "insiders") contained in the Federal Reserve Act and Regulation O apply to all insured institutions and their subsidiaries and holding companies. These restrictions include limits on loans to one borrower and conditions that must be met before such a loan can be made. There is also an aggregate limitation on all loans to insiders and their related interests. These loans cannot exceed the institution's total unimpaired capital and surplus, and the FDIC may determine that a lesser amount is appropriate. Insiders are subject to enforcement actions for knowingly accepting loans in violation of applicable restrictions.

Restrictions on Distribution of Subsidiary Bank Dividends and Assets. Dividends paid by the Banks have provided a substantial part of the Company's operating funds and, for the foreseeable future, it is anticipated that dividends paid by the Banks will continue to be its principal source of operating funds. Capital adequacy requirements serve to limit the amount of dividends that may be paid by the subsidiaries. Under federal law, the subsidiaries cannot pay a dividend if, after paying the dividend, a particular subsidiary will be "undercapitalized." The FDIC may declare a dividend payment to be unsafe and unsound even though the bank would continue to meet its capital requirements after the dividend. Neither of the formal agreements entered into by NBG or BNB restrict the ability of the banks to pay dividends to the Company, provided the minimum capital requirements set forth in the agreements are met.

Because the Company is a legal entity separate and distinct from its subsidiaries, the Company's right to participate in the distribution of assets

of any subsidiary upon the subsidiary's liquidation or reorganization will be subject to the prior claims of the subsidiary's creditors. In the event of a liquidation or other resolution of an insured depository institution, the claims of depositors and other general or subordinated

creditors are entitled to a priority of payment over the claims of holders of any obligation of the institution to its shareholders, including any depository bank holding company (such as the Company) or any shareholder or creditor thereof.

Examinations. The New York State Banking Department (in the case of WCB and FTB), the Office of the Comptroller of the Currency (in the case of NBG and BNB), the Federal Reserve Board and the FDIC periodically examine and evaluate the Banks. Based upon such examinations, the appropriate regulator may revalue the assets of the institution and require that it establish specific reserves to compensate for the difference between what the regulator determines the value to be and the book value of such assets.

Audit Reports. Insured institutions with total assets of $500 million or more at the beginning of a fiscal year must submit annual audit reports prepared by independent auditors to federal and state regulators. In some instances, the audit report of the institution's holding company can be used to satisfy this requirement. Auditors must receive examination reports, supervisory agreements and reports of enforcement actions. In addition, financial statements prepared in accordance with generally accepted accounting principles, management's certifications concerning responsibility for the financial statements, internal controls and compliance with legal requirements designated by the FDIC, and an attestation by the auditor regarding the statements of management relating to the internal controls must be submitted. The FDIC Improvement Act of 1991 requires that independent audit committees be formed, consisting of outside directors only. The committees of institutions with assets of more than $3 billion must include members with experience in banking or financial management must have access to outside counsel and must not include representatives of large customers.

Capital Adequacy Requirements. The FDIC has adopted regulations establishing minimum requirements for the capital adequacy of insured institutions. The FDIC may establish higher minimum requirements if, for example, a bank has previously received special attention or has a high susceptibility to interest rate risk.

The FDIC's risk-based capital guidelines generally require banks to have a minimum ratio of Tier 1 capital to total risk-weighted assets of 4.0% and a ratio of total capital to total risk-weighted assets of 8.0%. The capital categories have the same definitions for the Company. As of December 31, 2003, the ratio of Tier 1 capital to total risk-weighted assets for the Banks was 8.91% for WCB, 11.15% for NBG, 13.69% for BNB, and 10.90% for FTB, and the ratio of total capital to total risk-weighted assets was 10.16% for WCB, 12.41% for NBG, 14.94% for BNB, and 12.16% for FTB. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital Resources."

The FDIC's leverage guidelines require banks to maintain Tier 1 capital of no less than 4.0% of average total assets, except in the case of certain highly rated banks for which the requirement is 3.0% of average total assets. As of December 31, 2003, the ratio of Tier 1 capital to average total assets (leverage ratio) was 6.71% for WCB, 8.04% for NBG, 8.02% for BNB, and 6.09% for FTB. See "Management's Discussion and Analysis of Financial Condition and Results of Operations--Liquidity and Capital Resources."

As part of the agreements in place with their primary regulator, NBG and BNB were required to develop capital plans enabling them to achieve, by March 31, 2004, Tier 1 leverage capital equal to 8% of risk-weighted assets, Tier 1 risk-based capital equal to 10% of risk-weighted assets, and total risk-based capital of 12% of risk-weighted assets. Each of the banks meets the required levels at December 31, 2003.

Corrective Measures for Capital Deficiencies. The federal banking regulators are required to take "prompt corrective action" with respect to capital-deficient institutions. Agency regulations define, for each capital category, the levels at which institutions are "well-capitalized," "adequately capitalized," "undercapitalized," "significantly undercapitalized" and "critically undercapitalized." A "well-capitalized" bank has a total risk-based capital ratio of 10.0% or higher; a Tier 1 risk-based capital ratio of 6.0% or higher; a leverage ratio of 5.0% or higher; and is not subject to any written agreement, order or directive requiring it to maintain a specific capital level for any capital measure. An "adequately capitalized" bank

has a total risk-based capital ratio of 8.0% or higher; a Tier 1 risk-based capital ratio of 4.0% or higher; a leverage ratio of 4.0% or higher (3.0% or higher if the bank was rated a composite 1 in its most recent examination report and is not experiencing significant growth); and does not meet the criteria for a well-capitalized bank. A bank is "undercapitalized" if it fails to meet any one of the "adequately capitalized" ratios.

In addition to requiring undercapitalized institutions to submit a capital restoration plan, agency regulations contain broad restrictions on certain activities of undercapitalized institutions including asset growth, acquisitions, branch establishment and expansion into new lines of business. With certain exceptions, an insured depository institution is prohibited from making capital distributions, including dividends, and is prohibited from paying management fees to control persons if the institution would be undercapitalized after any such distribution or payment.

As an institution's capital decreases, the FDIC's enforcement powers become more severe. A significantly undercapitalized institution is subject to mandated capital raising activities, restrictions on interest rates paid and transactions with affiliates, removal of management and other restrictions. The FDIC has only very limited discretion in dealing with a critically undercapitalized institution and is virtually required to appoint a receiver or conservator.

Banks with risk-based capital and leverage ratios below the required minimums may also be subject to certain administrative actions, including the termination of deposit insurance upon notice and hearing, or a temporary suspension of insurance without a hearing in the event the institution has no tangible capital.

Deposit Insurance Assessments. The bank subsidiaries must pay assessments to the FDIC for federal deposit insurance protection. The FDIC has adopted a risk-based assessment system as required by the FDIC Improvement Act. Under this system, FDIC-insured depository institutions pay insurance premiums at rates based on their risk classification. Institutions assigned to higher risk classifications (that is, institutions that pose a greater risk of loss to their respective deposit insurance funds) pay assessments at higher rates than institutions that pose a lower risk. An institution's risk classification is assigned based on its capital levels and the level of supervisory concern the institution poses to the regulators. In addition, the FDIC can impose special assessments in certain

instances.

The FDIC maintains a process for raising or lowering all rates for insured institutions semi-annually if conditions warrant a change. Under this system, the FDIC has the flexibility to adjust the assessment rate schedule twice a year without seeking prior public comment, but only within a range of five cents per $100 above or below the premium schedule adopted. The FDIC can make changes in the rate schedule outside the five-cent range above or below the current schedule only after a full rulemaking with opportunity for public comment.

The Deposit Insurance Fund Act of 1996 contained a comprehensive approach to recapitalizing the Savings Association Insurance Fund and to assuring the payment of the Financing Corporation's bond obligations. Under this law, banks insured under the Bank Insurance Fund are required to pay a portion of the interest due on bonds that were issued by the Financing Corporation in 1987 to help shore up the ailing Federal Savings and Loan Insurance Corporation.

Enforcement Powers. The FDIC and the other federal banking agencies have broad enforcement powers, including the power to terminate deposit insurance, impose substantial fines and other civil and criminal penalties and appoint a conservator or receiver. Failure to comply with applicable laws, regulations and supervisory agreements could subject the Company or its banking subsidiaries, as well as the officers, directors and other institution-affiliated parties of these organizations, to administrative sanctions and potentially substantial civil money penalties.

Brokered Deposit Restrictions. Adequately capitalized institutions cannot accept, renew or roll over brokered deposits except with a waiver from the FDIC, and are subject to restrictions on the interest rates that can be paid on such deposits. Undercapitalized institutions may not accept, renew or roll over

brokered deposits. The Company's NBG and BNB subsidiaries for purposes of brokered deposit restrictions are deemed to be adequately capitalized institutions.

Cross-Guarantee Provisions. The Financial Institutions Reform, Recovery and Enforcement Act of 1989 ("FIRREA") contains a "cross-guarantee" provision which generally makes commonly controlled insured depository institutions liable to the FDIC for any losses incurred in connection with the failure of a commonly controlled depository institution.

Community Reinvestment Act. The Community Reinvestment Act of 1977 ("CRA") and the regulations issued hereunder are intended to encourage banks to help meet the credit needs of their service area, including low and moderate income neighborhoods, consistent with the safe and sound operations of the banks. These regulations also provide for regulatory assessment of a bank's record in meeting the needs of its service area when considering applications regarding establishing branches, mergers or other bank or branch acquisitions. FIRREA requires federal banking agencies to make public a rating of a bank's performance under the CRA. In the case of a bank holding company, the CRA performance record of the banks involved in the transaction are reviewed in connection with the filing of an application to acquire ownership or control of shares or assets of a bank or to merge with any other bank holding company. An unsatisfactory record can substantially delay or block the transaction.

Consumer Laws and Regulations. In addition to the laws and regulations discussed herein, the subsidiary banks are also subject to certain consumer laws and regulations that are designed to protect consumers in transactions with banks.

While the list set forth herein is not exhaustive, these laws and regulations include, among others, the Truth in Lending Act, the Truth in Savings Act, the Electronic Funds Transfer Act, the Expedited Funds Availability Act, the Equal Credit Opportunity Act, the Fair Housing Act, the Home Mortgage Disclosure Act, the Real Estate Settlement Procedures Act, and the "Check 21" Act. These laws and regulations mandate certain disclosure requirements and regulate the manner in which financial institutions must deal with customers when taking deposits or making loans to such customers. The Banks must comply with the applicable provisions of these consumer protection laws and regulations as part of their ongoing customer relations.

Changing Regulatory Structure

Gramm-Leach-Bliley Act

The Gramm-Leach-Bliley Act ("Gramm-Leach") was signed into law on November 12, 1999. Gramm-Leach permits, subject to certain conditions, combinations among banks, securities firms and insurance companies beginning March 11, 2000. Under Gramm-Leach, bank holding companies are permitted to offer their customers virtually any type of financial service including banking, securities underwriting, insurance (both underwriting and agency), and merchant banking. In order to engage in these additional financial activities, a bank holding company must qualify and register with the Board of Governors of the Federal Reserve System as a "financial holding company" by demonstrating that each of its bank subsidiaries is "well capitalized," "well managed," and has at least a "satisfactory" rating under the CRA. On May 12, 2000 the Company received approval from the Federal Reserve Bank of New York to become a financial holding company resulting in the eventual formation of FIGI and acquisition of BGI as previously discussed. During 2003, the Company terminated its financial holding company status and now operates as a bank holding company. The change in status did not affect the non-financial subsidiaries or activities being conducted by the Company, although future acquisitions or expansions of non-financial activities may require prior Federal Reserve Board approval and will be limited to those that are permissible for bank holding companies. Gramm-Leach establishes that the federal banking agencies will regulate the banking activities of financial holding companies and banks' financial subsidiaries, the U.S. Securities and Exchange Commission will regulate their securities activities and state insurance regulators will regulate their insurance activities. Gramm-Leach also provides new protections against the transfer and use by financial institutions of consumers' nonpublic, personal information.

The major provisions of Gramm-Leach are:

Financial Holding Companies and Financial Activities. Title I establishes a comprehensive framework to permit affiliations among commercial banks, insurance companies, securities firms, and other financial service providers by revising and expanding the Bank Holding Company Act framework to permit a holding company system to engage in a full range of financial activities through qualification as a new entity known as a financial holding company. A bank holding company that qualifies as a financial holding company can expand into a wide variety of services that are financial in nature, if its subsidiary depository institutions are well-managed, well-capitalized and have received at least a "satisfactory" rating on their last CRA examination. Services that have been deemed to be financial in nature include securities underwriting, dealing and market making, sponsoring mutual funds and investment companies, insurance underwriting and agency activities and merchant banking.

Title I also required the FDIC to adopt regulations implementing Section 121 of

Title I, regarding permissible activities and investments of insured state banks. Final regulations adopted by the FDIC in January 2001, in the form of amendments to Part 362 of the FDIC rules and regulations, provide the framework for subsidiaries of state nonmember banks to engage in financial activities that Gramm-Leach permits national banks to conduct through a financial subsidiary. The regulations require that prior to commencing such financial activities, a state nonmember bank must notify the FDIC of its intent to do so, and must certify that it is well-managed and that it and all of its subsidiary insured depository institutions are well-capitalized after deducting its investment in the new subsidiary. Furthermore, the regulations require that the notifying bank must, and must continue to, (i) disclose the capital deduction in published financial statements, and (ii) comply with sections 23A and 23B of the Federal Reserve Act and (iii) comply with all required financial and operational safeguards.

Activities permissible for financial subsidiaries of national banks, and, pursuant to Section 362 of the FDIC rules and regulations, also permissible for financial subsidiaries of state nonmember banks, include, but are not limited to, the following: (a) Lending, exchanging, transferring, investing for others, or safeguarding money or securities; (b) Insuring, guaranteeing, or indemnifying against loss, harm, damage, illness, disability, or death, or providing and issuing annuities, and acting as principal, agent, or broker for purposes of the foregoing, in any State; (c) Providing financial, investment, or economic advisory services, including advising an investment company; (d) Issuing or selling instruments representing interests in pools of assets permissible for a bank to hold directly; and (e) Underwriting, dealing in, or making a market in securities.

Securities Activities. Title II narrows the exemptions from the securities laws previously enjoyed by banks, requires the Federal Reserve Board and the SEC to work together to draft rules governing certain securities activities of banks and creates a new, voluntary investment bank holding company.

Insurance Activities. Title III restates the proposition that the states are the functional regulators for all insurance activities, including the insurance activities of federally-chartered banks, and bars the states from prohibiting insurance activities by depository institutions. The law encourages the states to develop uniform or reciprocal rules for the licensing of insurance agents.

Privacy. Under Title V, federal banking regulators were required to adopt rules that have limited the ability of banks and other financial institutions to disclose non-public information about consumers to nonaffiliated third parties. These limitations require disclosure of privacy policies to consumers and, in some circumstances, allow consumers to prevent disclosure of certain personal information to a nonaffiliated third party. Federal banking regulators issued final rules on May 10, 2000 to implement the privacy provisions of Title V. Under the rules, financial institutions must provide:

- initial notices to customers about their privacy policies, describing the conditions under which they may disclose nonpublic personal information to nonaffiliated third parties and affiliates;
- annual notices of their privacy policies to current customers; and
- a reasonable method for customers to "opt out" of disclosures to nonaffiliated third parties.

Compliance with the rules is mandatory after July 1, 2001. The Company and the banks were in full compliance with the rules as of or prior to their respective effective dates.

Safeguarding Confidential Customer Information. Under Title V, federal banking regulators are required to adopt rules requiring financial institutions to implement a program to protect confidential customer information. In January 2000, the federal banking agencies adopted guidelines requiring financial institutions to establish an information security program to:

- identify and assess the risks that may threaten customer information;
- develop a written plan containing policies and procedures to manage and control these risks;
- implement and test the plan; and
- adjust the plan on a continuing basis to account for changes in technology, the sensitivity of customer information and internal or external threats to information security.

The Banks' approved security programs appropriate to their size and complexity and the nature and scope of their operations prior to the July 1, 2001 effective date of the regulatory guidelines. The implementation of the programs is an ongoing process.

Community Reinvestment Act Sunshine Requirements. In February 2001, the federal banking agencies adopted final regulations implementing Section 711 of Title VII, the CRA Sunshine Requirements. The regulations require nongovernmental entities or persons and insured depository institutions and affiliates that are parties to written agreements made in connection with the fulfillment of the institution's CRA obligations to make available to the public and the federal banking agencies a copy of each agreement. The regulations impose annual reporting requirements concerning the disbursement, receipt and use of funds or other resources under these agreements. The effective date of the regulations was April 1, 2001. Neither the Company nor the banks is a party to any agreement that would be the subject of reporting pursuant to the CRA Sunshine Requirements.

The Company continues to evaluate the strategic opportunities presented by the broad powers granted to bank holding companies that elect to be treated as financial holding companies. In the event that the Company determines that access to the broader powers of a financial holding company is in the best interests of the Company, its shareholders and the banks, the Company will file the appropriate election with the Federal Reserve Board.

USA Patriot Act

As part of the Uniting and Strengthening America by Providing Appropriate Tools Required to Intercept and Obstruct Terrorism Act of 2001 ("USA Patriot Act"), signed into law on October 26, 2001, Congress adopted the International Money Laundering Abatement and Financial Anti-Terrorism Act of 2001 ("IMLAFATA"). IMLAFATA authorizes the Secretary of the Treasury, in consultation with the heads of other government agencies, to adopt special measures applicable to banks, bank holding companies, or other financial institutions. During 2002, the Department of Treasury issued a number of regulations relating to enhanced recordkeeping and reporting requirements for certain financial transactions that are of primary money laundering concern, due diligence requirements concerning the beneficial ownership of certain types of accounts, and restrictions or prohibitions on certain types of accounts with foreign financial institutions. Covered financial institutions also are barred from dealing with foreign "shell" banks. In addition, IMLAFATA expands the circumstances under which funds in a

bank account may be forfeited and requires covered financial institutions to respond under certain circumstances to requests for information from federal banking agencies within 120 hours.

Regulations were also adopted during 2002 to implement minimum standards to verify customer identity, to encourage cooperation among financial institutions, federal banking agencies, and law enforcement authorities regarding possible money laundering or terrorist activities, to prohibit the anonymous use of "concentration accounts," and to require all covered financial institutions to have in place a Bank Secrecy Act compliance program. IMLAFATA also amends the Bank Holding Company Act and the Bank Merger Act to require the federal banking agencies to consider the effectiveness of a financial institution's anti-money laundering activities when reviewing an application under these acts.

The Banks have in place a Bank Secrecy Act compliance program, and they engage in very few transactions of any kind with foreign financial institutions or foreign persons.

Sarbanes-Oxley Act

On July 30, 2002, the President signed into law the Sarbanes-Oxley Act of 2002 (the "Act") implementing legislative reforms intended to address corporate and accounting fraud. In addition to the establishment of a new accounting oversight board that enforces auditing, quality control and independence standards and is funded by fees from all publicly traded companies, the law restricts provision of both auditing and consulting services by accounting firms. To ensure auditor independence, any non-audit services being provided to an audit client requires pre-approval by the issuer's audit committee members. In addition, the audit partners must be rotated. The Act requires chief executive officers and chief financial officers, or their equivalent, to certify to the accuracy of periodic reports filed with the SEC, subject to civil and criminal penalties if they knowingly or willfully violate this certification requirement. In addition, under the Act, legal counsel is required to report evidence of a material violation of the securities laws or a breach of fiduciary duty by a company to its chief executive officer or its chief legal officer, and, if such officer does not appropriately respond, to report such evidence to the audit committee or other similar committee of the board of directors or the board itself.

Longer prison terms and increased penalties are also applied to corporate executives who violate federal securities laws, the period during which certain types of suits can be brought against a company or its officers has been extended, and bonuses issued to top executives prior to restatement of a company's financial statements are subject to disgorgement if such restatement was due to corporate misconduct. Executives are also prohibited from insider trading during retirement plan "blackout" periods, and loans to company executives are restricted. The Act accelerates the time frame for disclosures by public companies, as they must immediately disclose any material changes in their financial condition or operations. Directors and executive officers must also provide information for most changes in ownership in a company's securities within two business days of the change.

The Act also prohibits any officer or director of a company or any other person acting under their direction from taking any action to fraudulently influence, coerce, manipulate or mislead any independent public or certified accountant engaged in the audit of the company's financial statements for the purpose of rendering the financial statement's materially misleading. The Act also requires the SEC to prescribe rules requiring inclusion of an internal control report and assessment by management in the annual report to stockholders. In addition, the

Act requires that each financial report required to be prepared in accordance with (or reconciled to) accounting principles generally accepted in the United States of America and filed with the SEC reflect all material correcting adjustments that are identified by a "registered public accounting firm" in accordance with accounting principles generally accepted in the United States of America and the rules and regulations of the SEC.

Effective August 29, 2002, as directed by Section 302(a) of the Act, the Company's chief executive officer and chief financial officer are each required to certify that the Company's quarterly and annual reports do not contain any untrue statement of a material fact. The Act imposes several requirements, including having these officers certify that: they are responsible for establishing, maintaining and regularly evaluating the effectiveness of the Company's internal controls; they have made certain disclosures to the Company's auditors and the audit committee of the Board of Directors about the Company's internal controls; and they have included information in the Company's quarterly and annual reports about their evaluation and whether there have been significant changes in the Company's internal controls or in other factors that could significantly affect internal controls during the last quarter.

Fair Credit Reporting Act

In 1970, the U. S. Congress enacted the Fair Credit Reporting Act (the "FCRA") in order to ensure the confidentiality, accuracy, relevancy and proper utilization of consumer credit report information. Under the framework of the FCRA, the United States has developed a highly advanced and efficient credit reporting system. The information contained in that broad system is used by financial institutions, retailers and other creditors of every size in making a wide variety of decisions regarding financial transactions. Employers, and law enforcement agencies have also made wide use of the information

collected and maintained in databases made possible by the FCRA. The FCRA affirmatively preempts state law in a number of areas, including the ability of entities affiliated by common ownership to share and exchange information freely, the requirements on credit bureaus to reinvestigate the contents of reports in response to consumer complaints, among others. By its terms, the preemption provisions of the FCRA were to terminate as of December 31, 2003. With the enactment of the Fair and Accurate Transactions Act (FACT Act) in late 2003, the preemption provisions of FCRA were extended, although the FACT Act imposes additional requirements on entities that gather and share consumer credit information. The FACT Act requires the Federal Reserve Board and the Federal Trade Commission to issue final regulations within nine months of the effective date of the Act. The provisions of these implementing regulations, and their effect on the Company's banks, cannot be determined at this time.

Expanding Enforcement Authority

The Federal Reserve Board, the Office of the Comptroller of Currency, the New York State Superintendent of Banks and the FDIC possess extensive authority to police unsafe or unsound practices and violations of applicable laws and regulations by depository institutions and their holding companies. For example, the FDIC may terminate the deposit insurance of any institution, which it determines has engaged in an unsafe or unsound practice. The agencies can also assess civil money penalties, issue cease and desist or removal orders, seek injunctions, and publicly disclose such actions. The OCC has indicated, in the case of NBG, that it is considering whether civil money penalties should be imposed for certain of the violations of law identified in its Report of Examination for the period ended September 30, 2002.

Effect On Economic Environment

The policies of regulatory authorities, including the monetary policy of the Federal Reserve Board, have a significant effect on the operating results of bank holding companies and their subsidiaries. Among the means available to the Federal Reserve Board to affect the money supply are open market operations in U.S. Government securities, changes in the discount rate on member bank borrowings and changes in reserve requirements against member bank deposits. These means are used in varying combinations to influence overall growth and distribution of bank loans, investments and deposits, and their use may affect interest rates charged on loans or paid for deposits. Federal Reserve Board monetary policies have materially affected the operating results of commercial banks in the past and are expected to continue to do so in the future.

2003 Regulatory Developments

On September 4, 2003, the boards of NBG and BNB entered into formal agreements with their primary regulator, the OCC. Under the terms of the agreements, NBG and BNB, without admitting any violations, agreed to take certain actions designed to assure that their operations are in accordance with applicable laws and regulations. The agreements require them, among other things, to: appoint a Compliance Committee of the Board; develop, implement and ensure compliance with a written plan outlining actions to be taken to address regulatory recommendations set forth in the reports of examination, review and assess the capabilities of management; develop various policies and programs to reduce credit risk and identify problem loans and to adopt policies that will permit them to declare dividends only when they are in compliance with their approved capital plans and applicable laws, and upon prior written notice to (but not with the consent of) the OCC. The boards of both banks have taken, or are in the process of taking, the actions required by the agreements, and the Company has implemented a compliance monitoring program to track and monitor compliance within each bank of each requirement in the formal agreements.

Both banks were required to develop capital plans that will enable them to achieve, by March 31, 2004, Tier 1 leverage capital equal to 8% of risk-weighted assets, Tier 1 risk-based capital equal to 10% of risk-weighted assets, and total risk-based capital of 12% of risk-weighted assets. Interim levels, to be achieved by December 31, 2003, were also established, at 6.25%, 9.0% and 11.0%, respectively, for Bath, and 7.0%, 9.0% and 10.5%, respectively, for NBG. Following the closing of the credit facility with M&T Bank in December 2003, loan proceeds were downstreamed to NBG and BNB so that the capital levels required to be achieved by March 31, 2004 were met by December 31, 2003.

The NBG agreement also requires its board of directors to adopt, implement and ensure adherence to a written policy on extensions of overdraft credit and limit the circumstances under which NBG will be permitted to extend credit to its affiliates, and requires the bank to engage an independent appraiser to provide updated real estate appraisals where required.

The BNB agreement also requires its board of directors to adopt, implement and ensure adherence to a written action plan outlining proposed corrective action addressing issues in the pre-existing Matters Requiring Attention pertaining to interest rate risk measurement and monitoring systems.

Also on September 4, 2003, in a letter to the Federal Reserve Bank of New York, the Company's primary regulator, the Company terminated its financial holding company status and began operating instead as a bank holding company. The change

in status will not affect any non-financial subsidiaries or activities currently being conducted by the Company, although it will mean that future acquisitions or expansions of non-financial activities may require prior Federal Reserve Board approval and will be limited to those that are permissible for bank holding companies.

The Company believes that it has made substantial progress to date in enhancing its risk management and governance practices while working with management and Boards of NBG and BNB to address the various requirements set forth in the formal agreements. There can be no assurance, however, as to the precise timing for determining that all required corrective actions have been taken to the appropriate satisfaction of the OCC. The Board and senior management team are committed to the goal of establishing and maintaining "best practices" at both the Company and the bank level in the areas of governance, corporate conduct, risk management and regulatory compliance, and to meeting all of the banks' commitments to their regulators. While the Company believes that substantial progress has been made in this pursuit to date, the Company also recognizes that this remains an important ongoing effort requiring dedication and a commitment of resources at all levels of the holding company and the banks.

Item 2. Properties

The Company's headquarters and operations center is located in Warsaw, New York. This facility is leased for a nominal rent from the Wyoming County Industrial Development Agency for local tax reasons and the Company has the right to purchase it for nominal consideration beginning in November 2006. The following table lists the properties of each of the Company's subsidiaries:

ENTITY \ LOCATION	TYPE OF FACILITY	LEASED OR OWNED	EXPIRATIO OF LEASE
Wyoming County Bank			
Warsaw	Main Office	Own	--
Attica	Branch	Own	--
Batavia	Branch	Lease	September 2
Batavia (In-Store)	Branch	Lease	August 20
Dansville	Branch	Lease	March 201
East Aurora	Branch	Lease	March 201
Geneseo	Branch	Own	--
Lakeville	Branch	Own	--
Mount Morris	Branch	Own	--
North Java	Branch	Own	--
North Warsaw	Branch	Own	--
Orchard Park	Branch	Ground Lease	January 20
Pavilion	Branch	Own	--
Strykersville	Branch	Own	--
Williamsville	Branch	Lease	May 2005
Wyoming	Branch	Own	--
Yorkshire	Branch	Lease	November 2
National Bank of Geneva			
Geneva	Main Office	Own	--
Geneva	Drive-up Branch	Own	--
Geneva (Plaza)	Branch	Ground Lease	January 20
Caledonia	Branch	Lease	April 200

Canandaigua	Branch	Own	--
Honeoye Falls	Branch	Lease	September 2
Leroy	Branch	Own	--
North Chili	Branch	Own	--
Ovid	Branch	Own	--
Penn Yan	Branch	Own	--
Victor	Branch	Own	--
Waterloo	Branch	Own	--
Bath National Bank			
Bath	Main Office	Own	--
Bath	Drive-up Branch	Own	--
Avoca	Branch	Own	--
Avoca	Drive-up Branch	Lease	September 2
Cohocton	Closed Branch	Lease	August 20
Dundee	Branch	Own	--
Elmira	Branch	Own	--
Elmira Heights	Branch	Lease	August 20
Erwin	Branch	Lease	August 20
Hammondsport	Branch	Own	--
Hornell	Branch	Own	--
Horseheads	Branch	Lease	October 20
Naples	Branch	Own	--
Wayland	Branch	Own	--
First Tier Bank & Trust			
Olean	Main Office	Own	--
Olean	Drive-up Branch	Own	--
Allegany	Branch	Own	--
Cuba	Branch	Own	--
Ellicottville	Branch	Own	--
Lakewood	Branch	Own	--
Salamanca	Branch	Own	--
Burke Group			
Honeoye Falls	Main Office	Lease	December 2
Syracuse	Branch	Lease	April 200

Item 3. Legal Proceedings

From time to time the Company and its subsidiaries are parties to or otherwise involved in legal proceedings arising in the normal course of business. Management does not believe that there is any pending or threatened proceeding against the Company or its subsidiaries, which, if determined adversely, would have a material effect on the Company's business, results of operations or financial condition.

Item 4. Submission of Matters to a Vote of Security Holders

No matters were submitted during the fourth quarter of the year ended December 31, 2003 to a vote of security holders.

PART II

Item 5. Market for Registrant's Common Stock and Related Stockholder Matters

The common stock of the Company is traded under the symbol of FISI on the Nasdaq

National Market. At March 1, 2004, the Company had 11,172,673 shares of common stock outstanding (exclusive of treasury shares) and approximately 2,400 shareholders of record. The following chart lists prices of actual sales transactions as reported by Nasdaq, as well as the Company's cash dividends declared.

	Sales Price			Cash Dividends
	High	Low	Close	Declared
2003				
First Quarter	$ 29.75	$ 19.05	$ 19.82	$ 0.16
Second Quarter	27.23	18.94	23.53	0.16
Third Quarter	27.20	21.80	21.92	0.16
Fourth Quarter	29.40	22.00	28.23	0.16
2002				
First Quarter	$ 30.00	$ 23.33	$ 29.11	$ 0.13
Second Quarter	38.85	28.74	37.86	0.14
Third Quarter	38.25	24.35	27.15	0.15
Fourth Quarter	32.04	25.05	29.36	0.16

The Company pays regular quarterly cash dividends on its common stock, and the Board of Directors presently intends to continue the payment of regular quarterly cash dividends, subject to the need for those funds for debt service and other purposes. However, because substantially all of the funds available for the payment of dividends are derived from the Banks, future dividends will depend upon the earnings of the Banks', their financial condition and need for funds. Furthermore, there are a number of federal banking policies and regulations that restrict the Company's ability to pay dividends. For further discussion on dividend restrictions, please refer to page 14, as these restrictions may have the effect of reducing the amount of dividends that the Company can declare to its shareholders.

Item 6. Selected Financial Data

(Dollars in thousands)	December 31				
	2003	2002	2001	2000	1999
Selected Financial Condition Data					
Total assets	$2,173,732	$2,105,034	$1,794,296	$1,289,327	$1,136,46
Loans	1,345,347	1,321,892	1,166,050	887,145	763,74
Allowance for loan losses	29,064	21,660	19,074	13,883	11,42
Securities available for sale	604,964	596,862	428,423	257,823	197,13
Securities held to maturity	47,131	47,125	61,281	76,947	81,35
Deposits	1,818,891	1,708,523	1,433,658	1,078,111	949,53
Borrowed funds	154,247	195,479	190,389	62,384	56,33
Shareholders' equity	183,103	178,294	149,187	131,618	117,53

(Dollars in thousands)	For the years ended December 31				
	2003	2002	2001	2000	1999

Selected Results of Operations Data					
Interest income	$ 111,450	$ 118,439	$ 114,468	$ 96,467	$ 78,69
Interest expense	35,949	42,585	49,694	43,605	31,88
Net interest income	75,501	75,854	64,774	52,862	46,80
Provision for loan losses	22,526	6,119	4,958	4,211	3,06
Net interest income after Provision for loan loss	52,975	69,735	59,816	48,651	43,74
Noninterest income	26,072	22,189	15,782	9,409	8,05
Noninterest expense (3)	60,823	53,049	43,352	30,156	27,03
Income before income taxes	18,224	38,875	32,246	27,904	24,77
Income taxes	3,977	12,419	11,033	9,804	8,81
Net income	$ 14,247	$ 26,456	$ 21,213	$ 18,100	$ 15,95

	At or for the years ended December 31				
	2003	2002	2001	2000	
Per Common Share Data					
Net income - basic	$ 1.14	$ 2.26	$ 1.79	$ 1.51	$
Net income - diluted	1.13	2.23	1.77	1.51	
Cash dividends declared on common stock	0.64	0.58	0.48	0.42	
Book value	14.81	14.46	11.93	10.36	
Market value	28.23	29.36	23.40	13.61	
Selected Financial Ratios and Other Data					
Performance Ratios:					
Return on common equity	7.65%	17.01%	15.84%	15.78%	
Return on assets	0.66	1.35	1.34	1.51	
Common dividend payout	56.14	25.66	26.82	27.81	
Net interest rate spread	3.62	3.96	3.96	3.98	
Net interest margin (1)	3.95	4.37	4.62	4.87	
Efficiency ratio	55.73	50.62	48.49	45.19	
Noninterest income to average total assets (2)	1.16	1.11	0.96	0.76	
Noninterest expenses to average total assets	2.82	2.70	2.73	2.52	
Average interest-earning assets to average interest bearing liabilities	118.62	117.82	119.67	123.25	1
Asset Quality Ratios:					
Non-performing loans to total loans	3.82%	2.81%	0.86%	0.80%	
Non-performing assets to total loans and other real estate	3.87	2.90	0.94	0.91	
Allowance for loan losses to non-performing loans	56	58	190	195	
Allowance for loan losses to total loans	2.16	1.64	1.64	1.56	
Net charge-offs during the period to average loans outstanding during the year	1.11	0.30	0.23	0.21	
Capital ratios:					
Equity to total assets	8.42%	8.47%	8.31%	10.21%	
Average common equity to average assets	7.74	7.47	7.84	8.78	
Other Data:					

Number of full-service offices	48	47	41	32	
Loans serviced for others (in millions)	$439.5	$356.4	$302.3	$205.2	$
Full time equivalent employees	744	685	608	441	

(1) Net interest income divided by average interest earning assets. A tax-equivalent adjustment to interest earned from tax-exempt securities has been computed using a federal tax rate of 35%.

(2) Noninterest income excludes net gain (loss) on sale of securities available for sale.

(3) Noninterest expense includes goodwill amortization, which amounted to $1,653,000 for 2001 compared to zero in all other years presented.

(Dollars in thousands)	First Quarter	Second Quarter	T Qu
Selected Quarterly Financial Information			
2003			
Results of operations data:			
Interest income	$28,527	$28,764	
Interest expense	9,686	9,571	
Net interest income	18,841	19,193	
Provision for loan losses	3,298	5,311	
Net interest income after provision for loan losses	15,543	13,882	
Noninterest income	6,102	6,160	
Noninterest expense	15,576	14,947	
Income before income taxes	6,069	5,095	
Income taxes	1,773	1,445	
Net income	4,296	3,650	
Per common share data:			
Net income - basic	$0.35	$0.29	
Net income - diluted	0.35	0.29	
Cash dividends declared	0.16	0.16	
Book value	14.57	15.11	
Market value	19.82	23.53	

	First Quarter	Second Quarter	T Qu
2002			
Results of operations data:			
Interest income	$28,560	$29,927	
Interest expense	10,483	10,941	
Net interest income	18,077	18,986	
Provision for loan losses	1,007	1,181	
Net interest income after provision for loan losses	17,070	17,805	
Noninterest income	4,937	5,157	

Noninterest expense	12,100	13,093
Income before income taxes	9,907	9,869
Income taxes	3,250	3,225
Net income	6,657	6,644
Per common share data:		
Net income - basic	$0.57	$0.57
Net income - diluted	0.56	0.56
Cash dividends declared	0.13	0.14
Book value	12.26	13.23
Market value	29.11	37.86

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

GENERAL

The principal objective of this discussion is to provide an overview of the financial condition and results of operations of the Company during the year ended December 31, 2003 and the preceding two years. This discussion and tabular presentations should be read in conjunction with the accompanying consolidated financial statements and accompanying notes.

Income. The Company's results of operations are dependent primarily on net interest income, which is the difference between the income earned on loans and securities and the cost of funds, consisting of the interest paid on deposits and borrowings. Results of operations are also affected by the provision for loan losses, service charges on deposits, financial services group fees and commissions, mortgage banking activities, gain or loss on the sale or call of investment securities and other miscellaneous income.

Expenses. The Company's expenses primarily consist of salaries and employee benefits, occupancy and equipment, supplies and postage, amortization of intangible assets, computer and data processing, professional fees, other miscellaneous expense and income tax expense. Results of operations are also significantly affected by general economic and competitive conditions, particularly changes in interest rates, government policies and the actions of regulatory authorities.

OVERVIEW

Net income was $14.2 million, $26.5 million and $21.2 million for 2003, 2002 and 2001, respectively. Diluted earnings per share for the year ended December 31, 2003 was $1.13, compared to $2.23 in 2002 and $1.77 in 2001. The return on average common equity in 2003 was 7.65%, compared to 17.01% in 2002 and 15.84% in 2001. The return on average assets in 2003 was 0.66%, compared to 1.35% in 2002 and 1.34% in 2001.

Net interest income, the principal source of the Company's earnings, was $75.5 million in 2003 comparable to $75.9 million in 2002. Net interest margin was 3.95% for the year ended December 31, 2003, a drop of 42 basis points from the 4.37% level for last year.

The most significant item affecting 2003 financial results was the provision for loan losses, which totaled $22.5 million in 2003, an increase of $16.4 million over the $6.1 million provision for loan losses in 2002. Credit quality issues made 2003 a challenging year for the Company. High levels of nonperforming loans

with associated charge-offs and increases to the allowance for loan losses significantly impacted financial results. Nonperforming assets increased to $52 million at December 31, 2003 compared to $38 million at December 31, 2002. Nonperforming agricultural credits, principally dairy farms, have increased $10 million since December 31, 2002. Total nonperforming agricultural loans were $22 million at December 31, 2003 or 9.40% of total agricultural loans. Borrower cash flows in the dairy industry have recently improved due to some stabilization and upward movement in milk prices. Net loan charge-offs were $15 million, or 1.11% of average loans, for the year ended December 31, 2003 compared to $4 million, or 0.30% of average loans for 2002. Commercial and commercial mortgage loans represented $11 million of net charge-offs in 2003.

During 2003, increased regulatory oversight was put in place in the form of formal agreements at the two national banks, NBG and BNB. In addition, the Company's management placed a renewed focus on risk management, from both a corporate and credit perspective. This included expansion of the position formerly known as Chief Credit Officer to Chief Risk Officer. The Company has committed substantial resources to credit administration and underwriting functions with the goal of increasing consistency among subsidiary banks in reporting and grading loans, and strengthening the review and oversight of subsidiary bank lending and credit administration at the holding company level.

The Company's future challenges include managing existing credit quality issues as well as continuing to strengthen and standardize the current loan underwriting process. Significant resources have been invested in building an infrastructure necessary to manage the current credit issues and to support future

growth. Management is now faced with the challenge of leveraging that infrastructure to grow revenues by investing in quality assets.

CRITICAL ACCOUNTING POLICIES

The Company's consolidated financial statements are prepared in accordance with accounting principles generally accepted in the United States and are consistent with predominant practices in the financial services industry. Application of critical accounting policies, which are those policies that Management believes are the most important to the Company's financial position and results, requires Management to make estimates, assumptions, and judgments that affect the amounts reported in the consolidated financial statements and accompanying notes and are based on information available as of the date of the financial statements. Future changes in information may affect these estimates, assumptions and judgments, which, in turn, may affect amounts reported in the financial statements.

The Company has numerous accounting policies, of which the most significant are presented in Note 1 of the notes to consolidated financial statements. These policies, along with the disclosures presented in the other financial statement notes and in this discussion, provide information on how significant assets, liabilities, revenues and expenses are reported in the consolidated financial statements and how those reported amounts are determined. Based on the sensitivity of financial statement amounts to the methods, assumptions, and estimates underlying those amounts, Management has determined that the accounting policies with respect to the allowance for loan losses and goodwill require particularly subjective or complex judgments important to the Company's financial position and results of operations, and, as such, are considered to be critical accounting policies as discussed below.

Allowance for Loan Losses: The allowance for loan losses represents management's estimate of probable credit losses inherent in the loan portfolio. Determining the amount of the allowance for loan losses is considered a critical accounting estimate because it requires significant judgment and the use of subjective measurements including management's assessment of the internal risk classifications of loans, changes in the nature of the loan portfolio, industry concentrations and the impact of current local, regional and national economic factors on the quality of the loan portfolio. Changes in these estimates and assumptions are reasonably possible and may have a material impact on the Company's consolidated financial statements, results of operations or liquidity. For additional discussion related to the Company's accounting policies for the allowance for loan losses, see Note 1 of the notes to consolidated financial statements.

Goodwill: Statement of Financial Accounting Standard (SFAS) No. 142, "Goodwill and Other Intangible Assets" prescribes the accounting for goodwill and intangible assets subsequent to initial recognition. The provisions of SFAS No. 142 discontinue the amortization of goodwill and intangible assets with indefinite lives. Instead, these assets are subject to at least an annual impairment review, and more frequently if certain impairment indicators are in evidence. Changes in the estimates and assumptions used to evaluate impairment may have a material impact on the Company's consolidated financial statements, results of operations or liquidity. During 2003, the Company evaluated goodwill for impairment using a discounted cash flow analysis and determined no impairment existed. For additional discussion related to the Company's accounting policy for goodwill and other intangible assets, see Note 1 of the notes to the consolidated financial statements.

NET INCOME ANALYSIS

Average Balance Sheet
The following table sets forth certain information relating to the Company's consolidated statements of financial condition and reflects the average yields earned on interest-earning assets, as well as the average rates paid on interest-bearing liabilities for the years indicated. Such yields and rates were derived by dividing interest income or expense by the average balances of interest-earning assets or interest-bearing liabilities, respectively, for the years shown. Tax equivalent adjustments have been made. All average balances are average daily balances. Nonaccrual loans are included in the yield calculations in this table.

	Year ended December 31					
	2003			2002		
(Dollars in thousands)	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate	Average Outstanding Balance	Interest Earned/ Paid	Yield/ Rate
Interest-earning assets:						
Federal funds sold and interest bearing deposits	$ 45,361	$ 505	1.11%	$ 28,889	$ 494	1.71
Investment securities (1):						
Taxable	387,799	16,073	4.14	364,356	19,109	5.24
Non-taxable	231,529	12,794	5.53	211,358	13,109	6.20

Total investment securities	619,328	28,867	4.66	575,714	32,218	5.59
Loans (2):						
Commercial and agricultural	859,709	51,196	5.96	766,818	52,177	6.80
Residential real estate	255,429	18,340	7.18	234,813	19,362	8.25
Consumer and home equity	242,491	17,020	7.02	233,173	18,776	8.05
Total loans	1,357,629	86,556	6.38	1,234,804	90,315	7.31
Total interest-earning assets	2,022,318	115,928	5.73	1,839,407	123,027	6.69
Allowance for loan losses	(25,135)			(20,030)		
Other non-interest earning assets	158,554			145,639		
Total assets	$2,155,737			$1,965,016		
Interest-bearing liabilities:						
Savings and money market	$ 411,587	$ 3,958	0.96%	$ 366,708	$ 5,768	1.57
Interest-bearing checking	389,267	3,547	0.91	354,687	5,059	1.43
Certificates of deposit	744,022	21,758	2.92	655,737	24,340	3.71
Borrowed funds	143,749	5,009	3.48	167,883	5,741	3.42
Guaranteed preferred beneficial interests in corporations junior subordinated debentures	16,200	1,677	10.35	16,200	1,677	10.35
Total interest-bearing liabilities	1,704,825	35,949	2.11	1,561,215	42,585	2.73
Non-interest bearing demand deposits	245,234			219,028		
Other non-interest-bearing liabilities	21,165			20,306		
Total liabilities	1,971,224			1,800,549		
Stockholders' equity (3)	184,513			164,467		
Total liabilities and stockholders' equity	$2,155,737			$1,965,016		
Net interest income		$ 79,979			$ 80,442	
Net interest rate spread			3.62%			3.96
Net earning assets	$ 317,493			$ 278,192		
Net interest income as a percentage of average interest-earning assets			3.95%			4.37
Ratio of average interest-earning assets to average interest-bearing liabilities			118.62%			117.82

(1) Amounts shown are amortized cost for held to maturity securities and fair value for available for sale securities. In order to make pre-tax income and resultant yields on tax-exempt securities comparable to those on taxable securities and loans, a tax-equivalent adjustment to interest earned from tax-exempt securities has been computed using a federal tax rate of 35%.

(2) Net of deferred loan fees and costs, and loan discounts and premiums.

(3) Includes unrealized gains/(losses) on securities available for sale.

Net Interest Income

Net interest income, the principal source of the Company's earnings, was $75.5 million in 2003 comparable to $75.9 million in 2002. Net interest margin was 3.95% for the year ended December 31, 2003, a drop of 42 basis points from the 4.37% level for the same period last year. Growth in average earning assets of $183 million, or 10%, served to partially offset the fall in net interest margin. The growth in average earning assets is comprised of average increases of $123 million and $60 million in loans and investment securities, respectively. The Company's yield on average earning assets was 5.73% for 2003, down 96 basis points from 6.69% from 2002. The Company's loan portfolio yield was 6.38% and tax-equivalent investment yield was 4.66% for 2003, each down 93 basis point from 2002. The decline in both categories is partially due to the historically low interest rate environment, which has led to repricing of variable rate loans and prepayments of higher yielding investment securities and redeployment of those funds at current market rates. Lost interest on the higher levels of nonaccrual loans has also contributed to the decline in loan portfolio yield.

Total average interest-bearing liabilities were $1.705 billion for the year ended December 31, 2003 representing a $144 million increase over 2002 and represented approximately 80% of the average increased funding required to support the growth in average earning assets. The principal funding source for the average earning asset growth was deposits, with the average for the year ended December 31, 2003 increasing $194 million or 12% over the average for the same period in 2002. Net interest margin declined in 2003, as general market interest rates declined to historically low levels. As overall interest rates have continued to remain low, the Company's yields on earning assets declined in 2003 more rapidly than the cost of funds.

The Company's cost of interest bearing liabilities was 2.11% for 2003, a drop of 62 basis points from 2002. Interest bearing liabilities represented approximately 85% of the funding sources for earning assets in 2003 and 2002 with the balance of earning assets being funded by net noninterest bearing funding sources. Net noninterest bearing funding sources represent the amount of zero interest cost funds such as demand deposits and equity that are available to fund earning assets after funding non-interest earning assets. Coupling the zero interest funding sources with interest bearing liabilities results in a total cost of funds for the Company in 2003 of 1.78%, down 54 basis points from the 2002 total cost of funds of 2.32%.

Net interest income was $75.9 million in 2002 compared with $64.8 million in 2001, an increase of $11.1 million or 17%. Average earning assets grew by $352 million to $1.839 billion in 2002, or 24% over 2001, which offset the effects of a 25 basis point decline in the net interest margin from 4.62% in 2001 to 4.37% in 2002. Total average interest-bearing liabilities were $1.561 billion for the year ended December 31, 2002, representing a $318 million increase over 2001 and

90% of the average increased funding required to support the growth in average earning assets.

Rate/Volume Analysis

The following table presents the extent to which changes in interest rates and changes in the volume of interest-earning assets and interest-bearing liabilities have affected the Company's interest income and interest expense during the periods indicated. Information is provided in each category with respect to: (i) changes attributable to changes in volume (changes in volume multiplied by current year rate); (ii) changes attributable to changes in rate (changes in rate multiplied by prior volume); and (iii) the net change. The changes attributable to the combined impact of volume and rate have been allocated proportionately to the changes due to volume and the changes due to rate.

	Year ended December 31				
	2003 vs. 2002			2002 vs. 2001	
(Dollars in thousands)	Increase/(Decrease) Due To Volume	Rate	Total Increase/ (Decrease)	Increase/(Decrease) Due To Volume	Rate
Interest-earning assets:					
Federal funds sold and interest-bearing deposits	$ 200	$ (189)	$ 11	$ 349	$ (213)
Investment securities:					
Taxable	971	(4,007)	(3,036)	5,957	(2,136)
Non-taxable	1,165	(1,480)	(315)	2,565	(735)
Total investment securities	2,136	(5,487)	(3,351)	8,522	(2,871)
Loans:					
Commercial and agricultural	5,965	(6,946)	(981)	11,249	(10,316)
Residential real estate	1,466	(2,488)	(1,022)	595	(1,426)
Consumer and home equity	657	(2,413)	(1,756)	1,300	(2,569)
Total loans	8,088	(11,847)	(3,759)	13,144	(14,311)
Total interest-earning assets	10,424	(17,523)	(7,099)	22,015	(17,395)
Interest-bearing liabilities:					
Savings and money market	432	(2,242)	(1,810)	1,807	(1,283)
Interest-bearing checking	311	(1,823)	(1,512)	2,606	343
Certificates of deposit	2,557	(5,138)	(2,581)	(1,500)	(10,220)
Borrowed funds	(833)	100	(733)	2,059	(1,158)
Junior subordinated debentures issued to unconsolidated subsidiary trust	--	--	--	240	(3)
Total interest-bearing liabilities	2,467	(9,103)	(6,636)	5,212	(12,321)

Net interest income	$ 7,957	$ (8,420)	$ (463)	$ 16,803	$ (5,074)

Provision for Loan Losses

The provision for loan losses represents management's estimate of the expense necessary to maintain the allowance for loan losses at a level representative of losses in the portfolio. The provision for loan losses was $22.5 million in 2003, compared to $6.1 million in 2002 and $5.0 million in 2001. The significant increase in the provision for loan losses during 2003 primarily relates to higher levels of nonperforming loans and charge-offs. Nonperforming loans increased to $51.5 million at December 31, 2003 compared to $37.1 million at December 31, 2002. Nonperforming agricultural credits, principally dairy farms, have increased $10 million since December 31, 2002 after a long period of depressed milk prices. Total nonperforming agricultural loans were $22 million at December 31, 2003 or 9.40% of total agricultural loans. Borrower cash flows in the dairy industry have recently improved due to some stabilization and upward movement in milk prices. Net loan charge-offs were $15 million, or 1.11% of average loans, for the year ended December 31, 2003 compared to $4 million, or 0.30% of average loans for 2002. Commercial and commercial mortgage loans represented $11 million of net charge-offs in 2003. The ratio of the allowance for loan losses to nonperforming loans was 56% at December 31, 2003 versus 58% at December 31, 2002. The ratio of allowance for loan losses to total loans was 2.16% and 1.64% at December 31, 2003 and 2002, respectively. See "Lending Activities" section for further discussion.

Noninterest Income

The following table presents the major categories of noninterest income during the years indicated:

	Year Ended December 31	
(Dollars in thousands)	2003	2002
Service charges on deposits	$ 11,461	$ 10,603
Financial services group fees and commissions	5,692	5,629
Mortgage banking activities	4,036	2,279
Gain on sale or call of securities	1,041	285
Other	3,842	3,393
Total noninterest income	$ 26,072	$ 22,189

Noninterest income increased 17% to $26.1 million in 2003 compared to $22.2 million in 2002. The increase in noninterest income is partially attributed to the growth in deposits and related service fees. The increase in mortgage banking activities, which includes gains and losses from the sale of loans, mortgage servicing income and the amortization and impairment of mortgage servicing rights, corresponds with the increase in residential mortgage refinancing activity resulting from the historically low interest rate

environment during 2003. Gains and losses from the sale of loans, the largest component of mortgage banking activities, totaled $3.2 million and $1.5 million in 2003 and 2002, respectively. The Company sells most fixed rate newly originated and refinanced mortgage loans in the secondary market and retains the servicing rights. The Company's loan servicing portfolio was $439 million at December 31, 2003 compared to $356 million at December 31, 2002.

Noninterest income increased 41% to $22.2 million in 2002 compared to $15.8 million in 2001. The increase in noninterest income is partially attributed to the growth in deposits and related service fees. In addition, the increase in financial services group fees and commissions reflects the ongoing expansion of the financial services line of business. In comparison to 2001, the year ended December 31, 2002 reflects a full year of fees and commissions generated by the Company's employee benefits administration and compensation consulting firm, BGI, acquired during the fourth quarter of 2001.

Noninterest Expense

The following table presents the major categories of noninterest expense during the years indicated:

	Year Ended December 31	
(Dollars in thousands)	2003	2002
Salaries and employee benefits	$ 33,825	$ 30,093
Occupancy and equipment	8,270	7,285
Supplies and postage	2,468	2,371
Amortization of goodwill	--	--
Amortization of other intangible assets	1,226	898
Computer and data processing	1,829	1,759
Professional fees	1,881	1,612
Other	11,324	9,031
Total noninterest expense	$ 60,823	$ 53,049

Noninterest expense was $60.8 million compared to $53.0 million in 2002. The overall increase in noninterest expense is generally attributed to higher credit collection costs, costs of opening new branch offices and costs for additional lending and credit administration staff. The Company's largest component of noninterest expense, salaries and employee benefits, increased 13% in 2003, primarily a reflection of staffing additions as previously indicated. Included in 2003 other expenses are the following items which increased substantially from the prior year: $1.1 million of other real estate expense, $683,000 of commercial loan expense and $544,000 of limited partnership expense. The additional noninterest expenses, coupled with a slowing of revenue growth, are the principal factors in an increase in the

Company's efficiency ratio to 55.7% for the year ended December 31, 2003, compared to 50.6% and 48.5% in 2002 and 2001, respectively.

Noninterest expense increased 22% to $53.0 million in 2002 compared to $43.4

million in 2001. The Company's largest component of noninterest expense, salaries and employee benefits, increased 31% in 2002, a reflection of staffing additions from acquisitions and other additions necessary to support the Company's growth. The increase also results from overhead coupled with integrating the newly acquired companies, expenditures associated with maintaining the Company's investment in technology and costs connected with opening new branch offices. In contrast, goodwill amortization expense recognized on the BNB acquisition, which amounted to $1.7 million in 2001, ceased on January 1, 2002 with the adoption of SFAS No. 142.

Income Tax Expense

The provision for income taxes provides for Federal and New York State income taxes, which amounted to $4.0 million, $12.4 million and $11.0 million for the years ended December 31, 2003, 2002 and 2001, respectively. The fluctuation in the provision for income taxes corresponds in general with taxable income levels for each year. The effective tax rate for 2003 was 21.8%, compared to 31.9% in 2002 and 34.2% in 2001. The lower effective tax rate in 2003 is primarily attributable to tax exempt interest income constituting a larger proportion of net income before income taxes.

Segment Information

In accordance with the provisions of SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information," the Company's reportable segments are comprised of WCB, NBG, BNB, FTB and FSG as the Company evaluates performance on an individual bank basis. During 2002 the Company completed a geographic realignment of the subsidiary banks, which involved the merger of the subsidiary formerly known as PSB into NBG and subsequent transfer of branches between NBG and WCB. Accordingly, the Company restated segment results to reflect the merger and transfers for each of the years presented. Financial information related to the Company's segments is presented in Note 17 of the notes to consolidated financial statements.

FINANCIAL CONDITION

At December 31, 2003 the Company had total assets of $2.174 billion, an increase of 3% from $2.105 billion at December 31, 2002. Total deposits were $1.819 billion at year-end 2003, compared with $1.709 billion a year earlier. Book value per common share at December 31, 2003 was $14.81, an increase of 2% from $14.46 at December 31, 2002.

At December 31, 2003 the Company's total shareholders' equity was $183 million compared to $178 million a year earlier. During the fourth quarter of 2003 the Company completed a debt-financing plan that raised $25 million. Approximately $15 million of the financing proceeds were contributed as capital to the Company's NBG and BNB subsidiaries allowing those banks to meet higher capital ratios required in agreements imposed by their regulator. See Note 15 of the notes to consolidated financial statements.

Lending Activities

Set forth below is selected information concerning the composition of the Company's loan portfolio.

At December 31

(Dollars in thousands)	2003	2002	2001	2000	1999
Commercial	$ 248,313	$ 262,630	$ 232,379	$ 169,832	$ 140,376
Commercial real estate	369,712	332,134	274,702	166,041	137,648
Agricultural	235,199	233,769	186,623	165,367	151,534
Residential real estate	251,502	251,898	240,141	201,160	189,149
Consumer and home equity	240,591	241,461	232,205	184,745	145,038
Total loans, gross	1,345,317	1,321,892	1,166,050	887,145	763,745
Allowance for loan losses	(29,064)	(21,660)	(19,074)	(13,883)	(11,421)
Total loans, net	$ 1,316,253	$ 1,300,232	$ 1,146,976	$ 873,262	$ 752,324

Gross loans increased slightly to $1.345 billion at December 31, 2003 from $1.322 billion at December 31, 2002, an increase of $23 million or 1.8%. Commercial loans decreased $14 million or 5.5%, while commercial real estate loans increased by $38 million or 11.3%. At December 31, 2003, commercial loans totaled $248 million, representing 18.5% of total loans, and commercial real estate loans totaled $370 million, representing 27.5% of total loans. At December 31, 2003, agricultural loans, which include agricultural real estate loans, totaled $235 million, representing 17.5% of the total loan portfolio.

As of December 31, 2003 and 2002, residential real estate loans remained flat at $252 million or 18.7% of total loans in 2003. Although the residential real estate loans portfolio remained flat year-over-year, the Company processed a significant number of mortgage applications during 2003 because of the historically low interest rate environment during 2003. The Company sells most qualifying newly originated and refinanced residential real estate mortgages on the secondary market. The sold and serviced residential real estate loan portfolio increased to $386 million at December 31, 2003 from $301 million at December 31, 2002. During 2003 and 2002, the Company sold residential real estate loans totaling $192 million and $139 million, respectively.

Gross loans increased to $1.322 billion at December 31, 2002 from $1.166 billion at December 31, 2001, an increase of $156 million or 13.4%, principally from continued expansion of the commercial, commercial real estate and agricultural loan portfolios. Commercial loans increased $30 million or 13.0%, while commercial real estate loans increased by $57 million or 20.9%. At December 31, 2002, commercial loans totaled $263 million, representing 19.9% of total loans, and commercial real estate loans totaled $332 million, representing 25.1% of total loans. At December 31, 2002, agricultural loans increased by $47 million or 25.3%, to $234 million, represented 17.7% of the total loan portfolio. The 2002 increases in commercial, commercial real estate and agricultural loans reflect the Company's expanded business development efforts.

As of December 31, 2002, residential real estate loans grew by $12 million or 4.9% from December 31, 2001, and totaled $252 million or 19.1% of total loans. The relatively small percentage increase in residential real estate loans in comparison to commercial loan types corresponds with the Company's trend towards selling newly originated residential real estate mortgages, which is evidenced by the increase in the sold and serviced loan portfolio to $301 million at December 31, 2002 from $246 million at December 31, 2001. During 2002 and 2001, the Company sold residential real estate loans totaling $139 million and $117 million, respectively.

The Company also offers a broad range of consumer loan products. Consumer and

home equity loans totaled $241 million at December 31, 2003 and 2002, representing 17.9% of the total loan portfolio at year-end 2003. The flat consumer portfolio is a reflection of an increase in home equity lines of credit offset by a decline in the Company's indirect lending program, which resulted from an increase in competition for automobile financing.

Nonaccrual Loans and Nonperforming Assets

During 2003, the Company's credit quality declined further, particularly in the agricultural sector. Nonperforming loans increased to $51.5 million at December 31, 2003 compared to $37.1 million at December 31, 2002. Nonperforming agricultural credits, principally dairy farms, have increased $10 million since December 31, 2002 after a long period of depressed milk prices. Total nonperforming agricultural loans were $22 million at December 31, 2003 or 9.40% of total agricultural loans. Net loan charge-offs were $15 million, or 1.11% of average loans, for the year ended December 31, 2003 compared to $4 million, or 0.30% of average loans for 2002. Commercial and commercial mortgage loans represented $11 million of net charge-offs in 2003.

The Company has performed a comprehensive analysis of each impaired loan over $250,000, including the borrower's paying capacity; assessed the collateral supporting the loans outstanding and made appropriate allocations of loss allowances. Various forms of collateral including receivables, inventory, livestock, equipment, real property and other assets, secure the majority of the nonperforming loans.

The following table sets forth information regarding nonaccrual loans and other nonperforming assets.

	At December 31				
(Dollars in thousands)	2003	2002	2001	2000	1999
Nonaccrual loans (1)					
Commercial	$ 12,983	$ 12,760	$ 2,623	$ 1,044	$ 1,159
Commercial real estate	11,745	8,407	3,344	1,619	1,373
Agricultural	18,870	8,739	1,529	2,881	1,455
Residential real estate	2,496	1,065	921	835	413
Consumer and home equity	578	915	541	217	375
Total nonaccrual loans	46,672	31,886	8,958	6,596	4,775
Restructured loans	3,069	4,129	--	--	--
Accruing loans 90 days or more delinquent	1,709	1,091	1,064	521	969
Total nonperforming loans	51,450	37,106	10,022	7,117	5,744
Other real estate owned	653	1,251	947	932	969
Total nonperforming assets	$ 52,103	$ 38,357	$ 10,969	$ 8,049	$ 6,713

Total nonperforming loans to total loans	3.82%	2.81%	0.86%	0.80%	0.75%
Total nonperforming assets to total loans and other real estate	3.87%	2.90%	0.94%	0.91%	0.88%

(1) Although loans are generally placed on nonaccrual status when they become 90 days or more past due they may be placed on nonaccrual status earlier if they have been identified by the Company as presenting uncertainty with respect to the collectibility of interest or principal.

Analysis of the Allowance for Loan Losses

The allowance for loan losses represents the estimated amount of probable credit losses in the Company's loan portfolio. The Company performs periodic, systematic reviews of its Banks' portfolios to identify these probable losses, and to assess the overall collectibility of these portfolios. These reviews result in the identification and quantification of loss factors, which are used in determining the amount of the allowance for loan losses. In addition, the Company periodically evaluates prevailing economic and business conditions, industry concentrations, changes in the size and characteristics of the portfolio and other pertinent factors. The allowance for loan losses is allocated to cover the estimated losses in each loan category based on the results of this detailed review. The process used by the Company to determine the overall allowance for loan losses is based on this analysis, taking into consideration management's judgment. Allowance methodology is reviewed on a periodic basis and modified as appropriate. Based on this analysis, the Company believes that the allowance for loan losses is fairly stated at December 31, 2003.

The following table sets forth an analysis of the activity in the allowance for loan losses for the periods indicated.

	Years Ended December 31				
(Dollars in thousands)	2003	2002	2001	2000	
Balance at beginning of year	$ 21,660	$ 19,074	$ 13,883	$ 11,421	$
Addition resulting from acquisitions	--	174	2,686	--	
Charge-offs:					
Commercial	8,891	1,771	1,003	466	
Commercial real estate	2,953	944	394	629	
Agricultural	1,876	106	58	85	
Residential real estate	215	98	178	113	
Consumer and home equity	2,107	1,499	1,319	905	
Total charge-offs	16,042	4,418	2,952	2,198	
Recoveries:					
Commercial	525	210	58	206	
Commercial real estate	35	69	23	22	
Agricultural	3	36	--	1	
Residential real estate	11	67	19	5	

Consumer and home equity	346	329	399	215	
Total recoveries	920	711	499	449	
Net charge-offs	15,122	3,707	2,453	1,749	
Provision for loan losses	22,526	6,119	4,958	4,211	
Balance at end of year	$29,064	$ 21,660	$ 19,074	$ 13,883	$
Ratio of net charge-offs during the year to average loans outstanding during the year	1.11%	0.30%	0.23%	0.21%	
Ratio of allowance for loan losses to total loans	2.16%	1.64%	1.64%	1.56%	
Ratio of allowance for loan losses to nonperforming loans	56%	58%	190%	195%	

At December 31, 2003, the Company's allowance for loan losses totaled $29 million, an increase of $7 million over the previous year-end. The allowance as a percentage of total loans was 2.16% and 1.64% at December 31, 2003 and 2002, respectively. The ratio of allowance for loan losses to nonperforming loans declined slightly to 56% at December 31, 2003 versus 58% at December 31, 2002. The allowance for loan losses at December 31, 2003 represents the estimated probable losses in the loan portfolio

based on the Company's comprehensive assessment of collateral values and borrower paying capacity on impaired loans in excess of $250,000 together with the Company's assessment of current economic conditions in the Company's market area. The results of these assessments showed that a provision for loan losses of $22.5 million was required and recorded during 2003.

The increase in commercial loan charge-offs to $8.9 million at December 31, 2003 from $1.8 million at December 31, 2002 related primarily to NBG, as the NBG subsidiary accounted for approximately 90% of the Company's increase in commercial loan charge-offs. In addition, over 60%, or $4.6 million of NBG's commercial loan charge-offs were attributed to four credit relationships.

The following table summarizes the loan delinquencies (excluding past due nonaccrual loans) in the loan portfolio as of December 31, 2003:

(Dollars in thousands)	60-89 Days	Accruing Loans 90 Days or More
Commercial	$ 1,426	$ 1,219
Commercial real estate	519	--
Agricultural	284	178
Residential real estate	524	106
Consumer and home equity	508	206
Total	$ 3,261	$ 1,709

Allocation of Allowance for Loan Losses

The following table sets forth the allocation of the allowance for loan losses by loan category at the dates indicated. The allocation is made for analytical purposes and is not necessarily indicative of the categories in which actual losses may occur. The total allowance is available to absorb losses from any segment of the loan portfolio.

	At December 31							
	2003		2002		2001		2000	
(Dollars in thousands)	Amount of Allowance for Loan Losses	Percent of Loans in Each Category to Total Loans	Amount of Allowance for Loan Losses	Percent of Loans in Each Category to Total Loans	Amount of Allowance for Loan Losses	Percent of Loans in Each Category to Total Loans	Amount of Allowan for Loan Losses	
Commercial	$ 7,739	18.4%	$ 5,321	19.9%	$ 4,376	19.9%	$ 2,9	
Commercial real estate	5,354	27.5	4,725	25.1	3,611	23.6	1,9	
Agricultural	6,078	17.5	3,711	17.7	2,341	16.0	2,2	
Residential real estate	1,447	18.7	1,414	19.1	1,700	20.6	1,1	
Consumer and home equity	2,161	17.9	2,007	18.2	2,578	19.9	1,8	
Unallocated	6,285	--	4,482	--	4,468	--	3,7	
Total	$ 29,064	100%	$ 21,660	100%	$ 19,074	100%	$ 13,8	

Loan Maturity and Repricing Schedule

The following table sets forth certain information as of December 31, 2003, regarding the amount of loans maturing or repricing in the portfolio. Demand loans having no stated schedule of repayment or maturity and overdrafts are reported as due in one year or less. Adjustable and floating-rate loans are included in the period in which interest rates are next scheduled to adjust rather than the period in which they contractually mature, and fixed-rate loans are included in the period in which the final contractual repayment is due.

	At December 31, 2003		
	Within One	One Through Five	After Five

(Dollars in thousands)	Year	Years	Years	Total
Commercial	$ 121,226	$ 75,081	$ 52,006	$ 248,3
Commercial real estate	10,534	40,525	318,653	369,7
Agricultural	59,990	48,113	127,096	235,1
Residential real estate	12,064	18,256	221,182	251,5
Consumer and home equity	9,759	109,802	121,030	240,5
Total loans	$ 213,573	$ 291,777	$ 839,967	$1,345,3
Loans maturing after one year:				
With a predetermined interest rate		$ 171,158	$ 236,295	
With a floating or adjustable rate		120,619	603,672	
		$ 291,777	$ 839,967	

Investing Activities

U.S. Treasury and Agency Securities. At December 31, 2003, the U.S. Treasury and agency securities portfolio totaled $211.9 million, all of which was classified as available for sale. The portfolio consisted entirely of U.S. federal agency securities. The U.S. agency security portfolio consists of primarily callable securities, as callable securities provide higher yields than similar securities without call features. During 2003 the Company also utilized U.S. agency discount notes as a short-term investment alternative, particularly at the NBG and BNB subsidiaries. At December 31, 2002, the U.S. Treasury and agency securities portfolio totaled $120.6 million, all of which was classified as available for sale. The portfolio consisted of $1.0 million in U. S. Treasury securities and $119.6 million in U. S. federal agency securities. The $91.3 million increase in the Company's investment in U.S. agency securities during 2003 relates to the utilization of agency discount notes as a cash management tool, as well as the overall attractiveness of U.S. agency securities from a yield, risk or liquidity perspective.

State and Municipal Obligations. At December 31, 2003, the portfolio of state and municipal obligations totaled $242.5 million, of which $195.4 million was classified as available for sale. At that date, $47.1 million was classified as held to maturity, with a fair value of $48.1 million. At December 31, 2002, the portfolio of state and municipal obligations totaled $222.0 million, of which $174.9 million was classified as available for sale. At that date, $47.1 million was classified as held to maturity, with a fair value of $48.1 million. Over the past few years, more favorable yields on new purchases of these securities, when compared to taxable investment alternatives, has led to growth in this portfolio. In addition, the Company has expanded its overall municipal banking relationship business that includes both deposit activities and investing in obligations issued by those municipalities.

Mortgage-Backed Securities. Mortgage-backed securities, all of which were classified as available for sale, totaled $192.7 million and $283.5 million at December 31, 2003 and 2002, respectively. The portfolio was comprised of $138.5 million of mortgage-backed pass-through securities, $45.1 million of collateralized mortgage obligations (CMOs) and $9.1 million of other asset-backed securities at December 31, 2003. The mortgage backed pass-through securities were predominantly issued by government sponsored enterpises (FNMA, FHLMC, or GNMA). Approximately 80% of the mortgage-

backed pass-through securities were in fixed rate securities that were most frequently formed with mortgages having an original balloon payment of five or seven years. The adjustable rate agency mortgage-backed securities portfolio is principally indexed to the one-year Treasury bill. The CMO portfolio consists of government issues and privately issued AAA rated securities. The other asset-backed securities are primarily Student Loan Marketing Association (SLMA) floaters, which are securities backed by student loans. At December 31, 2002 the portfolio consisted of $193.4 million of mortgage-backed pass-through securities, $78.6 million of CMOs and $11.5 million of SLMAs. The decrease in mortgage-backed securities is a result of significant prepayments of this security class during the year due to the historically low interest rate environment and redeployment of the funds in alternative investment vehicles, namely U.S. agency securities.

Corporate Bonds. The corporate bond portfolio, all of which was classified as available for sale, totaled $4.1 million and $13.9 million at December 31, 2003 and 2002, respectively. The decline in this class of securities relates to the liquidation of certain bonds to satisfy managements desire to decrease overall credit risk. The Company's investment policy limits investments in corporate bonds to no more than 10% of total investments and to bonds rated as Baa or better by Moody's Investors Service, Inc. or BBB or better by Standard & Poor's Ratings Services at the time of purchase.

Equity Securities. At December 31, 2003 and 2002, available for sale equity securities totaled $0.9 million and $3.9 million, respectively.

Security Yields and Maturities Schedule

The following table sets forth certain information regarding the carrying value, weighted average yields and contractual maturities of the Company's debt securities portfolio as of December 31, 2003. No tax equivalent adjustments were made to the weighted average yields.

	December 31, 2003						
	One Year or Less		More than One Year to Five Years		More than Five Years to Ten Years		After Te
(Dollars in thousands)	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost	Weighted Average Yield	Amortized Cost
Available for Sale:							
US Treasury and agency	$ 39,424	1.57%	$ 26,946	4.41%	$ 45,534	4.94%	$ 98,666
Mortgage-backed securities	176	2.28	20,520	4.67	82,698	4.43	86,518
State and municipal obligations	13,712	4.40	105,978	3.74	61,636	3.87	5,003
Corporate bonds	3,015	5.84	506	6.38	--	--	499
Total debt securities available for sale	$ 56,327	2.49%	$153,950	3.99%	$189,868	4.37%	$190,686

Held to Maturity:							
State and municipal obligations	$ 33,458	2.14%	$ 10,654	4.39%	$ 2,220	4.81%	$ 799
Total debt securities held to maturity	$ 33,458	2.14%	$ 10,654	4.39%	$ 2,220	4.81%	$ 799

Borrowing Activities

Outstanding borrowings at December 31, 2003 and 2002 are summarized as follows:

(Dollars in thousands)	2003	2002
Short-term borrowings:		
Federal funds purchased and securities sold under repurchase agreements	$22,525	$60,679
FHLB advances	26,500	26,000
Other	1,000	510
Total short-term borrowings	$50,025	$87,189
Long-term borrowings:		
FHLB advances	$62,469	$86,822
Other	25,051	5,268
Total long-term borrowings	$87,520	$92,090

Information related to Federal funds purchased and securities sold under repurchase agreements as of and for the years ended December 31, 2003, 2002 and 2001 is summarized as follows:

(Dollars in thousands)	2003	2002	2001
Weighted average interest rate at year-end	0.89%	1.50%	1.88%
Maximum outstanding at any month-end	$36,414	$61,951	$65,474
Average amount outstanding during the year	$30,284	$47,924	$33,157

The average amounts outstanding are computed using daily average balances. Related interest expense for 2003, 2002 and 2001 was $376,000, $ 951,000 and $1,108,000, respectively.

At December 31, 2003, the Company had outstanding various short and long-term FHLB advances with maturity dates extending through 2014. The FHLB advances bear interest at fixed rates ranging from 2.41% to 7.80% and the weighted average interest rate amounted to 4.47% as of December 31, 2003.

The Company's FHLB advances include $20.0 million in fixed-rate callable borrowings, which can be called by the FHLB on a quarterly basis. FHLB advances

are collateralized by $6.0 million of FHLB stock, mortgage loans with a carrying value of $84.2 million at December 31, 2003 and investment securities with a fair market value of $37.8 million at December 31, 2003. At December 31, 2003, the Company had remaining credit available of $27.8 million under lines of credit with the FHLB. The Company also had $74.3 million of remaining credit available under unsecured lines of credit with various banks at December 31, 2003. The Company also has available lines of credit with Farmer Mac permitting borrowings to a maximum of $25.0 million. Advances outstanding against the Farmer Mac lines at December 31, 2003 amounted to $1.0 million.

During 2003, FII expanded the terms of an existing credit agreement with M&T Bank to aid in achieving the capital plans established for its NBG and BNB subsidiaries. The credit agreement includes a $25.0 million term loan facility and a $5.0 million revolving loan facility. The term loan requires monthly payments of interest only, at a variable interest rate of London Interbank Offered Rate ("LIBOR") plus 1.75%, which was 2.98% as of December 31, 2003. The $25.0 million term loan is included in long-term borrowings on the consolidated statements of financial condition as principal installments are due as follows: $5 million in December 2006, $10 million in December 2007 and $10 million in December 2008. The $5 million revolving loan accrues interest at a rate of LIBOR plus 1.50%. There were no advances outstanding on the revolving loan as of December 31, 2003. The credit agreement includes affirmative financial covenants, all of which were met as of December 31, 2003. FII pledged the stock of its subsidiary banks as collateral for the credit facility.

Trust Preferred Securities and Junior Subordinated Debentures

On February 22, 2001, the Company established FISI Statutory Trust I (the "Trust"), which is a statutory business trust formed under Connecticut law. The Trust exists for the exclusive purposes of (i) issuing and selling 30 year guaranteed preferred beneficial interests in the trust assets ("trust preferred" or "capital" securities) in the aggregate amount of $16.2 million at a fixed rate of 10.20%, (ii) using the proceeds from the sale of the capital securities to acquire the junior subordinated debentures issued by the Company and (iii) engaging in only those other activities necessary, advisable or incidental thereto.

The Company's junior subordinated debentures are the primary assets of the Trust and, accordingly, payments under the corporation obligated junior debentures are the sole revenue of the Trust. The capital securities of the Trust are non-voting. The Company owns all of the common securities of the Trust. The Company used the net proceeds from the sale of the capital securities to partially fund the BNB acquisition. The capital securities qualified as Tier 1 capital under regulatory definitions as of December 31, 2003 and 2002.

The Company's primary sources of funds to pay interest on the debentures held by the Trust are current dividends from its subsidiary banks. Accordingly, the Company's ability to service the debentures is dependent upon the continued ability of the subsidiary banks to pay dividends to the Company. Since the junior subordinated debentures and trust preferred securities at December 31, 2003 and 2002, respectively are classified as debt for financial statement purposes, the tax-deductible expense associated with the capital securities is recorded as interest expense in the consolidated statements of income.

The Company incurred $487,000 in costs to issue the securities and the costs are being amortized over 20 years using the straight-line method

As of December 31, 2003, the Company deconsolidated the subsidiary Trust, which

had issued trust preferred securities, and replaced the presentation of such instruments with the Company's junior subordinated debentures issued to the subsidiary Trust. Such presentation reflects the adoption of FASB Interpretation No. 46 ("FIN 46 R"), "Consolidation of Variable Interest Entities."

Deposits

The Banks offer a broad array of core deposit products including checking accounts, interest-bearing transaction accounts, savings and money market accounts and certificates of deposit under $100,000. These core deposits totaled $1.552 billion or 85.3% of total deposits of $1.819 billion at December 31, 2003. The core deposit base consists almost exclusively of in-market accounts. Core deposits are supplemented with certificates of deposit over $100,000, which amounted to $267.1 million as of December 31, 2003, primarily from in-market municipal, business and individual customers. As of December 31, 2003, brokered certificates of deposit included in certificates of deposit over $100,000 totaled $125.4 million.

Total deposits at December 31, 2003 amounted to $1.819 billion, an increase of $110.4 million or 6.5% from $1.709 billion at December 31, 2002. Core deposit products were $1.507 billion or 88.2% of total deposits at December 31, 2002. Certificates of deposit over $100,000 totaled $201.8 million at December 31, 2002, which included $71.6 million in brokered certificates of deposit.

The daily average balances, percentage composition and weighted average rates paid on deposits for each of the years ended December 31, 2003, 2002 and 2001 are presented below:

	For the year ended December 31						
	2003			2002			
(Dollars in thousands)	Average Balance	Percent of Total Average Deposits	Weighted Average Rate	Average Balance	Percent of Total Average Deposits	Weighted Average Rate	
Interest-bearing checking	$ 389,267	21.8%	0.91%	$ 354,687	22.2%	1.43%	
Savings and money market	411,587	23.0	0.96	366,708	23.0	1.57	
Certificates of deposit under $100,000	509,056	28.4	2.93	438,587	27.5	3.80	
Certificates of deposit over $100,000	234,966	13.1	2.90	217,150	13.6	3.53	
Non-interest bearing accounts	245,234	13.7	--	219,028	13.7	--	
Total average deposits	$1,790,110	100.0%	1.63%	$1,596,160	100.0%	2.20%	$

The following table indicates the amount of the Company's certificates of deposit by time remaining until maturity as of December 31, 2003:

(Dollars in thousands)	At December 31, 2003				
	3 Months Or Less	Over 3 To 6 Months	Over 6 To 12 Months	Over 12 Months	Total
Certificates of deposit less than $100,000	$ 147,641	$ 105,578	$ 105,686	$ 143,661	$ 502,566
Certificates of deposit of $100,000 or more	92,378	35,401	39,033	100,304	267,116
Total certificates of deposit	$ 240,019	$ 140,979	$ 144,719	$ 243,965	$ 769,682

RECENT ACCOUNTING DEVELOPMENTS

In June 2002, the FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." SFAS No. 146 addresses financial accounting and reporting for costs associated with exit or disposal activities and nullifies Emerging Issues Task Force Issue No. 94-3, "Liability Recognition for Certain Employee Termination Benefits and Other Costs to Exit an Activity (including Certain Costs Incurred in a Restructuring)." SFAS No. 146 requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of a commitment to an exit or disposal plan. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002, with early application encouraged. SFAS No. 142 does not apply to costs associated with an exit activity that involves an entity newly acquired in a business combination. The provisions of SFAS No. 146 did not affect the Company's consolidated financial statements.

FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others," was issued in November 2002. FASB Interpretation No. 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of FASB Interpretation No. 45 are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements of interim or annual periods ending after December 15, 2002. The Company has provided the required disclosures. The Company adopted the recognition and measurement provisions of FASB Interpretation No. 45 effective January 1, 2003. The adoption did not have a material impact on the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 requires that certain financial instruments, which under previous guidance could be accounted for as equity, be accounted for as liabilities. Financial instruments affected include mandatorily redeemable securities, certain financial instruments that require or may require the issuer to buy back some of its shares in exchange for cash or other assets and certain obligations that can be settled with shares of stock. SFAS No. 150 is effective for financial

instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003 for all other financial instruments. The Company adopted the provisions of SFAS No. 150 on July 1, 2003. The adoption did not have a material impact on the Company's consolidated financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities". The objective of this interpretation is to provide guidance on how to identify a variable interest entities ("VIE") and determine when the assets, liabilities, non-controlling interests, and results of operations of a VIE need to be included in a company's consolidated financial statements. FIN 46 was effective for all VIEs created after January 31, 2003. However, the FASB postponed that effective date to December 31, 2003. In December 2003, the FASB issued a revised FIN 46 ("FIN 46R') which further delayed the effective date until March 31, 2004 for VIE's created prior to February 1, 2003. The requirements of FIN 46R resulted in the deconsolidation of the Company's wholly-owned subsidiary trust, formed to issue mandatorily redeemable preferred securities ("trust preferred securities"). The deconsolidation, as of December 31, 2003, results in the derecognition of the $16.2 million of trust preferred securities and the recognition of junior subordinated debentures of $16.7 million and investment in the subsidiary trust of $502,000 in the Company's 2003 consolidated statement of financial position.

In December 2003, the FASB issued a revision of SFAS No. 132, "Employers Disclosure about Pensions and Other Post Retirement Benefits" to expand disclosure requirements to include descriptions of plan assets, investment strategy, measurement dates, plan obligations, cash flows and components of net periodic benefit cost recognized during interim periods. The Company adopted the provisions of SFAS No. 132, as revised, on December 31, 2003. Required disclosures have been made in the notes to the consolidated financial statements.

LIQUIDITY

The objective of maintaining adequate liquidity is to assure the ability of the Company and its subsidiaries to meet their financial obligations. These obligations include the withdrawal of deposits on demand or at their contractual maturity, the repayment of borrowings as they mature, the ability to fund new and existing loan commitments and the ability to take advantage of new business opportunities. The Company and its subsidiaries achieve liquidity by maintaining a strong base of core customer funds, maturing short-term assets, the ability to sell securities, lines of credit, and access to capital markets.

Liquidity at the subsidiary bank level is managed through the monitoring of anticipated changes in loans, the investment portfolio, core deposits and wholesale funds. The strength of the subsidiary bank's liquidity position is a result of its base of core customer deposits. These core deposits are supplemented by wholesale funding sources that include credit lines with the other banking institutions, the FHLB, Farmer Mac and the Federal Reserve Bank.

The primary source of liquidity for the parent company is dividends from subsidiaries, lines of credit, and access to capital markets. Dividends from subsidiaries are limited by various regulatory requirements related to capital adequacy and earnings trends. The Company's subsidiaries rely on cash flows from operations, core deposits, borrowings, short-term liquid assets, and, in the case of non-banking subsidiaries, funds from the parent company.

The Company's cash and cash equivalents were $85.6 million at December 31, 2003, an increase of $37.2 million from the balance of $48.4 million at December 31, 2002. The principal sources of cash from financing activities were $110 million from the net increase in deposits, offset by $42 million of net decrease in borrowings and $9 million in dividend payments. The principal source of net cash

from

operating activities is the Company's net income of $14 million and loan sale proceeds. The Company utilized its cash in the following investing activities: $14 million in the net acquisition of securities, $37 million in the net origination of loans and $10 million in the purchase of premises and equipment.

An additional source of liquidity to the Company is provided from its ability to limit its investing activities and/or dispose of its securities and loans. Additional liquidity can be provided to the Company through limiting the growth in loans by offering terms and pricing that would not be competitive. Securities available for sale and newly originated loans could be sold to provide additional liquidity. The fair value of assets being sold is dependent upon market conditions at the time of sale and potentially could adversely affect the Company's earnings.

CONTRACTUAL OBLIGATIONS

The following table presents the Company's contractual obligations as of December 31, 2003:

	Total	Less Than 1 Year	1-3 Years	3-5 Years	More Than 5 Years
Operating Leases	$ 5,540	$ 651	$ 1,105	$ 942	$ 2,842
Long-term Borrowings	87,520	--	22,421	44,330	20,769
Junior subordinated debentures	16,702	--	--	--	16,702
Total Obligations	$ 109,762	$ 651	$ 23,526	$ 45,272	$ 40,313

OFF-BALANCE SHEET ARRANGEMENTS

The Company has an off-balance sheet arrangement, which includes the guarantee of distributions, and payments for redemption or liquidation of trust preferred securities issued by a wholly owned, deconsolidated subsidiary trust to the extent of funds held by the trust. Although the guarantee is not separately recorded, the obligation underlying the guarantee is fully reflected on the Company's consolidated statement of financial condition as junior subordinated debentures. The subsidiary's trust preferred securities currently qualify as Tier 1 capital under the Federal Reserve capital adequacy guidelines. For further information regarding the junior subordinated debentures issued to unconsolidated subsidiary trust, see Note 9 of the notes to consolidated financial statements.

In the normal course of business, the Company has outstanding commitments to extend credit, which are not reflected in the Company's consolidated financial statements. The commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. At December 31, 2003 letters of credit totaling $11.8 million and unused loan commitments of $271.9 million were contractually available. Comparable amounts for these commitments at December 31, 2002 were $13.4 million and $316.6 million, respectively. The total commitment amounts do not necessarily represent future cash requirements

as many of the commitments are expected to expire without funding. For further information regarding the outstanding loan commitments, see Note 4 of the notes to consolidated financial statements.

CAPITAL RESOURCES

The Federal Reserve Board has adopted a system using risk-based capital guidelines to evaluate the capital adequacy of bank holding companies. The guidelines require a minimum total risk-based capital ratio of 8.0%. Leverage ratio is also utilized in assessing capital adequacy with a minimum requirement that can range from 3.0% to 5.0%. The following table reflects the changes in the components of those ratios:

(Dollars in thousands)	2003	2002	2001
Total shareholders' equity	$ 183,103	$ 178,294	$ 149,187
Less: Unrealized gains/(losses) on securities available or sale	8,197	10,368	2,176
Disallowed goodwill and other intangible assets	43,556	44,667	39,256
Plus: Minority interests in consolidated subsidiaries	172	161	475
Qualifying trust preferred securities	16,200	16,200	12,408
Total Tier 1 capital	$ 147,722	$ 139,620	$ 120,638
Adjusted average assets	$2,102,061	$2,005,837	$1,718,034
Tier 1 leverage ratio	7.03%	6.96%	7.02%
Total Tier 1 capital	$ 147,722	$ 139,620	$ 120,638
Plus: Qualifying allowance for loan losses	18,270	17,813	15,417
Nonqualifying trust preferred securities	--	--	3,792
Total risk-based capital	$ 165,992	$ 157,433	$ 139,847
Net risk-weighted assets	$1,450,839	$1,421,160	$1,229,811
Total risk-based capital ratio	11.44%	11.08%	11.37%

The Company's Tier 1 leverage ratio was 7.03% at December 31, 2003. The ratio increased slightly from 6.96% at December 31, 2002. Total Tier 1 capital of $147.7 million at December 31, 2003 increased $8.1 million from $139.6 million at December 31, 2002. The increase in Tier 1 capital relates primarily to the increase in retained earnings resulting from 2003 net income of $14.2 million and reduced by $8.6 million in preferred and common dividends declared during 2003.

The Company's total risk-weighted capital ratio was 11.44% at December 31, 2003. The ratio increased from 11.08% at December 31, 2002. Total risk-based capital was $166.0 million at December 31, 2002 an increase of $8.6 million from $157.4 million at December 31, 2001. The increase is primarily attributed to the $8.3 million increase in Tier 1 capital previously discussed plus the slight increase in qualifying allowance for loan losses.

In addition, the formal agreements entered into by NBG and BNB with their primary regulator required both banks to develop capital plans enabling them to achieve, by March 31, 2004, a Tier 1 leverage capital ratio equal to 8%, a Tier 1 risk-based capital ratio equal to 10%, and a total risk-based capital ratio of 12%. Each of the banks meets the required levels at December 31, 2003. For further information regarding regulatory capital, see Note 15 of the notes to consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

MARKET RISK

The principal objective of the Company's interest rate risk management is to evaluate the interest rate risk inherent in certain assets and liabilities, determine the appropriate level of risk to the Company given its business strategy, operating environment, capital and liquidity requirements and performance objectives, and manage the risk consistent with the guidelines approved by the Company's Board of Directors. The Company's senior management is responsible for reviewing with the Board its activities and strategies, the effect of those strategies on the net interest margin, the fair value of the portfolio and the effect that changes in interest rates will have on the portfolio and exposure limits. Senior Management develops an Asset-Liability Policy that meets strategic objectives and regularly reviews the activities of the subsidiary banks. Each subsidiary bank board adopts an Asset-Liability Policy within the parameters of the overall FII Asset-Liability Policy and utilizes an asset/liability committee comprised of senior management of the bank under the direction of the bank's board.

The matching of assets and liabilities may be analyzed by examining the extent to which such assets and liabilities are "interest rate sensitive" and by monitoring the Company's interest rate sensitivity "gap." An asset or liability is said to be interest rate sensitive within a specific time period if it will mature or re-price within that time period. The interest rate sensitivity gap is defined as the difference between the amount of interest-earning assets maturing or re-pricing within a specific time period and the amount of interest-bearing liabilities maturing or re-pricing within that same time period. A gap is considered positive when the amount of interest rate sensitive assets exceeds the amount of interest rate sensitive liabilities. A gap is considered negative when the amount of interest rate sensitive liabilities exceeds the amount of interest rate sensitive assets. At December 31, 2003, the one-year gap position, representing the difference between the amount of interest-earning assets maturing or re-pricing within one year and interest-bearing liabilities maturing or re-pricing within one year, was a positive $540.4 million, or 24.9% of total assets. Accordingly, over the one-year period following December 31, 2003, the Company will have an estimated $540.4 million more in assets re-pricing than liabilities. Generally if rate-sensitive assets re-price sooner than rate-sensitive liabilities, earnings will be positively impacted in a rising rate environment. Conversely, in a declining rate environment, earnings will generally be negatively impacted. If rate-sensitive liabilities re-price sooner than rate-sensitive assets then generally earnings will be negatively impacted in a rising rate environment. Conversely, in a declining rate environment earnings will generally be positively impacted. Management believes that the positive gap position at December 31, 2003 will not have a material adverse effect on the Company's operating results.

Gap Analysis

The following table (the "Gap Table") sets forth the amounts of interest-earning assets and interest-bearing liabilities outstanding at December 31, 2003 which management anticipates, based upon certain assumptions, to re-price or mature in each of the future time periods shown. Except as stated below, the amount of assets and liabilities shown which re-price or mature during a particular period were determined in accordance with the earlier of the re-pricing date or the contractual maturity of the asset or liability. The table sets forth an approximation of the projected re-pricing of assets and liabilities at December 31, 2003, on the basis of contractual maturities, anticipated prepayments and scheduled rate adjustments within the selected time intervals. All non-maturity deposits (demand deposits and savings deposits) were assumed to become rate sensitive over time, with 1%, 3%, 4%, 15%, 14% and 63% of such deposits assumed to re-price in the periods of less than 30 days, 31 to 180 days, 181 to 365 days, 1 to 3 years, 3 to 5 years and more than 5 years, respectively. Prepayment and re-pricing rates can have a significant impact on the estimated gap. While management believes the assumptions used in modeling the Gap Table are reasonable, there can be no assurance that assumed prepayment and re-pricing rates will approximate actual future activity.

Gap Table

	December 31, 2003					
	Volumes Subject to Repricing					
(Dollars in thousands)	0-30 days	31-180 days	181-365 days	1-3 years	3-5 years	
Interest-earning assets:						
Federal funds sold and and interest-bearing deposits	$ 40,006	$ 75	$ --	$ --	$ --	$
Investment securities (1)	113,974	74,375	72,844	143,315	93,006	
Loans (2)	632,422	119,431	98,974	262,859	148,398	
Total interest-earning assets	786,402	193,881	171,818	406,174	241,404	
Interest-bearing liabilities:						
Interest-bearing checking, savings and money market deposits	4,901	24,507	29,408	117,633	117,633	
Certificates of deposit	110,234	267,254	144,963	197,490	48,035	
Borrowed funds (3)	7,247	18,719	4,467	27,864	50,016	
Total interest-bearing liabilities	122,382	310,480	178,838	342,987	215,684	
Period gap	$664,020	$(116,599)	$ (7,020)	$ 63,187	$ 25,720	$(
Cumulative gap	$664,020	$ 547,421	$ 540,401	$603,588	$629,308	$

Period gap to total assets	30.55%	(5.36)%	(0.32)%	2.91%	1.18%	
Cumulative gap to total assets	30.55%	25.18%	24.86%	27.77%	28.95%	
Cumulative interest-earning assets to cumulative interest-bearing liabilities	642.58%	226.47%	188.34%	163.22%	153.77%	

(1) Amounts shown include the amortized cost of held to maturity securities and the fair value of available for sale securities.

(2) Amounts shown include principal balance net of deferred loan fees and costs, unamortized premiums and discounts.

(3) Amounts shown include junior subordinated debentures.

Certain shortcomings are inherent in the method of analysis presented in the Gap Table. For example, although certain assets and liabilities may have similar maturities or periods to repricing, they may react in different degrees to changes in market interest rates. Also, the interest rates on certain types of assets and liabilities may fluctuate in advance of changes in market interest rates, while interest rates on other types may lag behind changes in market rates. Additionally, certain assets, such as adjustable-rate loans, have features which restrict changes in interest rates, both on a short-term basis and over the life of the asset. Further, in the event of changes in interest rates, prepayment and early withdrawal levels would likely deviate significantly from those assumed in calculating the table.

As a result of these shortcomings, the Company directs more attention on simulation modeling, such as "net interest income at risk" discussed below, rather than gap analysis. Even though the gap analysis reflects a ratio of cumulative gap to total assets within acceptable limits, the net interest income at risk simulation modeling is considered by management to be more informative in forecasting future income at risk.

Net Interest Income at Risk Analysis

In addition to the Gap Analysis, management uses a "rate shock" simulation to measure the rate sensitivity of the balance sheet. Rate shock simulation is a modeling technique used to estimate the impact of changes in rates on net interest income and economic value of equity. The following table sets forth the results of the modeling analysis at December 31, 2003:

Change in Interest Rates in Basis Points (Rate Shock)	Net Interest Income			Economic Value of Equity		
	Amount	$ Change	% Change	Amount	$ Change	% Change

(Dollars in thousands)

200	$ 82,800	$ 5,113	6.58%	$ 414,868	$ (32,092)	(7.18%)
100	80,406	2,719	3.50%	425,572	(21,388)	(4.79%)
Static	77,687	--	--	446,960	--	--
(100)	72,072	(5,615)	(7.23%)	435,342	(11,618)	(2.60%)

The Company measures net interest income at risk by estimating the changes in net interest income resulting from instantaneous and sustained parallel shifts in interest rates of different magnitudes over a period of 12 months. As of December 31, 2003, a 200 basis point increase in rates would increase net interest income by $5.1 million, or 6.58%, over the next twelve-month period. A 100 basis point decrease in rates would decrease net interest income by $5.6 million, or 7.23%, over a twelve-month period. This simulation is based on management's assumption as to the effect of interest rate changes on assets and liabilities and assumes a parallel shift of the yield curve. It also includes certain assumptions about the future pricing of loans and deposits in response to changes in interest rates. Further, it assumes that delinquency rates would not change as a result of changes in interest rates, although there can be no assurance that this will be the case. While this simulation is a useful measure as to net interest income at risk due to a change in interest rates, it is not a forecast of the future results and is based on many assumptions that, if changed, could cause a different outcome.

Item 8. Financial Statements and Supplementary Data

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF FINANCIAL CONDITION
DECEMBER 31, 2003 AND 2002

(Dollars in thousands, except per share amounts)	2003	2002
Assets		
Cash, due from banks and interest-bearing deposits	$ 45,635	$ 48,429
Federal funds sold	40,006	--
Securities available for sale, at fair value	604,964	596,862
Securities held to maturity (fair value of $48,121 and $48,089 at December 31, 2003 and 2002, respectively)	47,131	47,125
Loans, net	1,316,253	1,300,232
Premises and equipment, net	34,239	27,254
Goodwill	40,621	40,593
Other assets	44,883	44,539
Total assets	$ 2,173,732	$ 2,105,034
Liabilities And Shareholders' Equity		
Liabilities:		
Deposits:		
Demand	$ 264,990	$ 240,755
Savings, money market and interest-bearing checking	784,219	779,772
Certificates of deposit	769,682	687,996

Total deposits	1,818,891	1,708,523
Short-term borrowings	50,025	87,189
Long-term borrowings	87,520	92,090
Junior subordinated debentures issued to unconsolidated subsidiary trust ("Junior subordinated debentures")	16,702	--
Guaranteed preferred beneficial interests in corporation's junior subordinated debentures ("Trust preferred securities")	--	16,200
Accrued expenses and other liabilities	17,491	22,738
Total liabilities	1,990,629	1,926,740
Shareholders' equity:		
3% cumulative preferred stock, $100 par value, authorized 10,000 shares, issued and outstanding 1,666 shares in 2003 and 2002	167	167
8.48% cumulative preferred stock, $100 par value, authorized 200,000 shares, issued and outstanding 175,683 shares in 2003 and 175,755 shares in 2002	17,568	17,575
Common stock, $ 0.01 par value, authorized 50,000,000 shares, issued 11,303,533 shares in 2003 and 2002	113	113
Additional paid-in capital	21,055	19,728
Retained earnings	136,938	131,320
Accumulated other comprehensive income	8,197	10,368
Treasury stock, at cost - 135,223 shares in 2003 and 199,719 shares in 2002	(935)	(977)
Total shareholders' equity	183,103	178,294
Total liabilities and shareholders' equity	$ 2,173,732	$ 2,105,034

See accompanying notes to consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

(Dollars in thousands, except per share amounts)	2003	2002	2001
Interest income:			
Loans	$ 86,556	$ 90,315	$ 91,48
Securities	24,389	27,630	22,62
Other	505	494	35
Total interest income	111,450	118,439	114,46

Interest expense:			
Deposits	29,263	35,167	43,41
Borrowings	5,009	5,741	4,84
Guaranteed preferred beneficial interests in corporation's junior subordinated debentures ("Trust preferred securities")	1,677	1,677	1,44
Total interest expense	35,949	42,585	49,69
Net interest income	75,501	75,854	64,77
Provision for loan losses	22,526	6,119	4,95
Net interest income after provision for loan losses	52,975	69,735	59,81
Noninterest income:			
Service charges on deposits	11,461	10,603	7,65
Financial services group fees and commissions	5,692	5,629	2,69
Mortgage banking activities	4,036	2,279	2,19
Gain on sale and call of securities	1,041	285	53
Other	3,842	3,393	2,71
Total noninterest income	26,072	22,189	15,78
Noninterest expense:			
Salaries and employee benefits	33,825	30,093	22,95
Occupancy and equipment	8,270	7,285	6,05
Supplies and postage	2,468	2,371	1,95
Amortization of goodwill	--	--	1,65
Amortization of other intangible assets	1,226	898	72
Computer and data processing	1,829	1,759	1,50
Professional fees	1,881	1,612	1,32
Other	11,324	9,031	7,18
Total noninterest expense	60,823	53,049	43,35
Income before income taxes	18,224	38,875	32,24
Income taxes	3,977	12,419	11,03
Net income	$ 14,247	$ 26,456	$ 21,21
Earnings per common share:			
Basic	$ 1.14	$ 2.26	$ 1.7
Diluted	$ 1.13	$ 2.23	$ 1.7

See accompanying notes to consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN
SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

(Dollars in thousands, except per share amounts)	3% Preferred Stock	8.48% Preferred Stock	Common Stock	Additional Paid in Capital	Retained Earnings	C
Balance - December 31, 2000	$ 171	$ 17,587	$ 113	$ 16,472	$ 98,348	
Purchase of 45 shares of 3% preferred stock	(4)	--	--	2	--	
Purchase of 11 shares of 8.48% preferred stock	--	(2)	--	--	--	
Purchase of 1,000 shares of common stock	--	--	--	--	--	
Issue 1,141 shares of common stock - directors plan	--	--	--	23	--	
Issue 34,452 shares of common stock - Burke Group, Inc. acquisition	--	--	--	698	--	
Comprehensive income:						
Net income	--	--	--	--	21,213	
Unrealized gain on securities available for sale (net of tax of $1,803)	--	--	--	--	--	
Reclassification adjustment for gains included in net income (net of tax of $215)	--	--	--	--	--	
Net unrealized gain on securities available for sale (net of tax of $1,588)						
Total comprehensive income						
Cash dividends declared:						
3% Preferred - $3.00 per share	--	--	--	--	(5)	
8.48% Preferred - $8.48 per share	--	--	--	--	(1,491)	
Common - $0.482 per share	--	--	--	--	(5,279)	
Balance - December 31, 2001	$ 167	$ 17,585	$ 113	$ 17,195	$112,786	
Purchase of 100 shares of 8.48% preferred stock	--	(10)	--	--	--	
Purchase of 22,240 shares of common stock	--	--	--	--	--	
Issue 1,049 shares of common stock - directors plan	--	--	--	33	--	
Issue 19,955 shares of common stock - exercised stock options	--	--	--	342	--	
Issue 36,700 shares of common stock - Burke Group, Inc. acquisition and earnout	--	--	--	840	--	
Issue 47,036 shares of common stock - Bank of Avoca acquisition	--	--	--	1,318	--	
Comprehensive income:						
Net income	--	--	--	--	26,456	
Unrealized gain on securities available for sale (net of tax of $5,603)	--	--	--	--	--	
Reclassification adjustment for gains included in net income (net of						

tax of$115)	--	--	--	--	--
Net unrealized gain on securities available for sale (net of tax of $5,488)					
Total comprehensive income					
Cash dividends declared:					
3% Preferred - $3.00 per share	--	--	--	--	(5)
8.48% Preferred - $8.48 per share	--	--	--	--	(1,491)
Common - $0.58 per share	--	--	--	--	(6,426)
Balance - December 31, 2002	$ 167	$ 17,575	$ 113	$ 19,728	$131,320
Purchase of 72 shares of 8.48% preferred stock	--	(7)	--	(1)	--
Purchase of 22,000 shares of common stock	--	--	--	--	--
Issue 2,440 shares of common stock - directors plan	--	--	--	34	--
Issue 21,669 shares of common stock - exercised stock options	--	--	--	259	--
Issue 62,387 shares of common stock - Burke Group, Inc. acquisition and earnout	--	--	--	1,035	--
Comprehensive income:					
Net income	--	--	--	--	14,247
Unrealized loss on securities available for sale (net of tax of ($1,120))	--	--	--	--	--
Reclassification adjustment for gains included in net income (net of tax of $415)	--	--	--	--	--
Net unrealized loss on securities available for sale (net of tax of ($1,535))					
Total comprehensive income					
Cash dividends declared:					
3% Preferred - $3.00 per share	--	--	--	--	(5)
8.48% Preferred - $8.48 per share	--	--	--	--	(1,490)
Common - $0.64 per share	--	--	--	--	(7,134)
Balance - December 31, 2003	$ 167	$ 17,568	$ 113	$ 21,055	$136,938

See accompanying notes to consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 2003, 2002 AND 2001

(Dollars in thousands)	2003	2002

Cash flows from operating activities:		
Net income	$ 14,247	$ 26,4
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	7,548	5,6
Provision for loan losses	22,526	6,1
Deferred income tax benefit	(1,971)	(1,0
Proceeds from sale of loans held for sale	192,295	139,4
Origination of loans held for sale	(190,205)	(140,5
Gain on sale and call of securities	(1,041)	(2
Gain on sale of loans held for sale	(3,153)	(1,5
(Gain) loss on sale of other assets	(25)	
Minority interest in net income of subsidiaries	31	1
Decrease (increase) in other assets	2,372	(2,6
(Decrease) increase in accrued expenses and other liabilities	(3,946)	6
Net cash provided by operating activities	38,678	32,5
Cash flows from investing activities:		
Purchase of securities:		
Available for sale	(425,849)	(425,2
Held to maturity	(32,890)	(35,1
Proceeds from maturity and call of securities:		
Available for sale	329,359	232,3
Held to maturity	32,812	43,4
Proceeds from sale and call of securities	82,906	45,0
Loan originations less principal payments	(37,483)	(143,6
Proceeds from sales of premises and equipment	81	
Purchase of premises and equipment	(10,439)	(5,2
Net cash paid in equity method investment	--	(2,4
Net cash acquired (paid) in purchase acquisitions	--	42,1
Net cash used in investing activities	(61,503)	(248,6
Cash flows from financing activities:		
Net increase in deposits	110,368	213,9
Net (decrease) increase in short-term borrowings	(37,164)	(16,5
Proceeds from long-term borrowings	29,000	23,0
Repayment of long-term borrowings	(33,570)	(1,3
Proceeds from trust preferred securities, net of costs	--	
Purchase of preferred and common shares	(425)	(5
Issuance of preferred and common shares	447	4
Dividends paid	(8,619)	(7,5
Net cash provided by financing activities	60,037	211,3
Net increase (decrease) in cash and cash equivalents	37,212	(4,7
Cash and cash equivalents at the beginning of the year	48,429	53,1
Cash and cash equivalents at the end of the year	$ 85,641	$ 48,4
Supplemental disclosure of cash flow information: Cash paid during year for:		
Interest	$ 37,466	$ 44,3
Income taxes	7,935	14,2
Noncash investing and financing activities:		

Fair value of noncash assets acquired in purchase acquisitions	$ --	$ 19,0
Fair value of liabilities assumed in purchase acquisitions	--	61,6
Issuance of common stock in purchase acquisitions/earnouts	1,340	2,4

See accompanying notes to consolidated financial statements.

FINANCIAL INSTITUTIONS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Summary of Significant Accounting Policies

Basis of Presentation

Financial Institutions, Inc. ("FII"), a bank holding company organized under the laws of New York State, and subsidiaries (the "Company") provide deposit, lending and other financial services to individuals and businesses in Central and Western New York State. FII and subsidiaries are each subject to regulation by certain federal and state agencies.

The consolidated financial statements include the accounts of FII, its four banking subsidiaries, Wyoming County Bank (99.65% owned) ("WCB"), National Bank of Geneva (100% owned) ("NBG"), First Tier Bank & Trust (100% owned) ("FTB") and Bath National Bank (100% owned) ("BNB"), collectively referred to as the "Banks". During 2002, the Company completed a geographic realignment of the subsidiary banks, which involved the merger of the subsidiary formerly known as The Pavilion State Bank ("PSB") into NBG and transfer of other branch offices between subsidiary banks. The merger and transfers were accounted for at historical cost as a combination of entities under common control.

During 2003, the Company disclosed that the Boards of Directors of its two national bank subsidiaries, NBG and BNB entered into agreements with their primary regulator, the Office of the Comptroller of the Currency ("OCC"). Under the terms of the agreements, NBG and BNB, without admitting any violations, have taken actions designed to assure that their operations are in accordance with applicable laws and regulations.

The Company formerly qualified as a financial holding company under the Gramm-Leach-Bliley Act, which allowed FII to expand business operations to include financial services businesses. The Company currently has two financial services subsidiaries: The FI Group, Inc. ("FIGI") and the Burke Group, Inc. ("BGI"), collectively referred to as the "Financial Services Group" ("FSG"). FIGI is a brokerage subsidiary that commenced operations as a start-up company in March 2000. BGI is an employee benefits and compensation consulting firm acquired by the Company in October 2001. During 2003, the Company terminated its financial holding company status to operate instead as a bank holding company. The change in status did not affect the non-financial subsidiaries or activities being conducted by the Company, although future acquisitions or expansions of non-financial activities may require prior Federal Reserve Board approval and will be limited to those that are permissible for bank holding companies.

In February 2001, the Company formed FISI Statutory Trust I ("FISI" or "Trust") (100% owned) and capitalized the trust with a $502,000 investment in FISI's common securities. The Trust was formed to accommodate the private placement of $16.2 million in capital securities ("trust preferred securities"), the proceeds of which were utilized to partially fund the acquisition of BNB. Effective December 31, 2003, the provisions of FASB Interpretation No. 46, "Consolidation of Variable Interest Entities," resulted in the deconsolidation of the Company's

wholly-owned Trust. The deconsolidation resulted in the derecognition of the $16.2 million in trust preferred securities and the recognition of $16.7 million in junior subordinated debentures and a $502,000 investment in the subsidiary trust recorded in other assets in the Company's 2003 consolidated statement of financial position.

The consolidated financial information included herein combines the results of operations, the assets, liabilities and shareholders' equity of the Company and its subsidiaries. All significant inter-company transactions and balances have been eliminated in consolidation.

The consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and prevailing practices in the banking industry. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, and the reported revenues and expenses for the period. Actual results could differ from those estimates.

Amounts in the prior years' consolidated financial statements are reclassified when necessary to conform to the current year's presentation.

Cash Equivalents

For purposes of the consolidated statements of cash flows, interest-bearing deposits and federal funds sold are considered cash equivalents.

Securities

The Company classifies its debt securities as either available for sale or held to maturity. Debt securities, which the Company has the ability and positive intent to hold to maturity, are carried at amortized cost and classified as held to maturity. Investments in other debt and equity securities are classified as available for sale and are carried at estimated fair value. Unrealized gains or losses related to securities available for sale are included in accumulated other comprehensive income, a component of shareholders' equity, net of the related deferred income tax effect.

A decline in the fair value of any security below cost that is deemed other than temporary is charged to income resulting in the establishment of a new cost basis for the security. Interest income includes interest earned on the securities adjusted for amortization of premiums and accretion of discounts on the related securities using the interest method. Realized gains or losses from the sale of available for sale securities are recognized on the trade date using the specific identification method.

Loans and Mortgage Banking Activities

Loans are stated at the principal amount outstanding, net of discounts and deferred loan origination fees and costs, which are recorded in interest income based on the interest method. Interest income on loans is recognized based on loan principal amounts outstanding at applicable interest rates. Accrual of interest on loans is suspended and all unpaid accrued interest is reversed when management believes, after considering collection efforts and the period of time past due, that reasonable doubt exists with respect to the collectibility of interest.

Loans, including impaired loans, are generally classified as nonaccrual if they

are past due as to maturity or payment of principal or interest for a period of more than 90 days (120 days for consumer loans), unless such loans are well-collateralized and in the process of collection. If a loan or a portion of a loan is internally classified as doubtful or is partially charged-off, the loan is classified as nonaccrual. Loans that are on a current payment status or past due less than 90 days may also be classified as nonaccrual if repayment in full of principal and/or interest is in doubt.

Loans may be returned to accrual status when all principal and interest amounts contractually due (including arrearages) are reasonably assured of repayment and there is a sustained period of repayment performance (generally a minimum of six months) in accordance with the contractual terms of the loan.

While a loan is classified as nonaccrual and the future collectibility of the recorded loan balance is uncertain, any payments received are generally used to reduce the principal balance. When the future collectibility of the recorded loan balance is expected, interest income may be recognized on a cash basis. In the case where a nonaccrual loan had been partially charged-off, recognition of interest on a cash basis is limited to that which would have been recognized on the recorded loan balance at the contractual interest rate. Interest collections in excess of that amount are recorded as recoveries to the allowance for loan losses until prior charge-offs have been fully recovered.

The Company originates and sells certain residential real estate loans in the secondary market. The Company typically retains the right to service the loan upon sale. The Company makes the determination of whether or not to identify a loan as held for sale at the time the application is received from the borrower. Loans held for sale are evaluated on an aggregate basis to determine if fair value is less than carrying value. If necessary, a valuation allowance is recorded by a charge to income for unrealized losses attributable to changes in market interest rates. There was no valuation allowance necessary at December 31, 2003 or 2002. Gains and losses on the disposition of loans held for sale are determined on the specific identification method. Loan servicing fees are recognized when payments are received.

Capitalized mortgage servicing rights are recorded at their fair value at the time a loan is sold and servicing rights are retained. Capitalized mortgage servicing rights are reported in other assets and are amortized to noninterest income in proportion to and over the period of estimated net servicing income. The Company uses a valuation model that calculates the present value of future cash flows to determine the fair value of servicing rights. In using this valuation method, the Company incorporates assumptions that market participants would use in estimating future net servicing income, which include estimates of the cost to service the loan, the discount rate, an inflation rate and prepayment speeds. The carrying value of originated mortgage servicing rights is periodically evaluated for impairment. Impairment is determined by stratifying rights by predominant risk characteristics, such as interest rates and terms, using discounted cash flows and market-based assumptions. Impairment is recognized through a valuation allowance, to the extent that fair value is less than the capitalized asset.

The Company also has rate lock commitments extended to borrowers that relate to the origination of residential mortgage loans ("rate locks"). To mitigate the interest rate risk inherent in rate locks, as well as closed mortgage loans held for sale ("loans held for sale"), the Company enters into forward commitments to sell individual mortgage loans ("forward commitments"). Rate locks and forward commitments are considered derivatives under SFAS No. 133. The impact of the estimated fair value of the rate locks and forward commitments was not

significant to the consolidated financial statements.

Mortgage banking activities (a component of noninterest income) consist of fees earned for servicing mortgage loans sold to third parties, gains (or losses) recognized on sales of mortgages, and amortization and impairment losses recognized on capitalized mortgage servicing assets.

Allowance for Loan Losses

The Company periodically evaluates the allowance for loan losses in order to maintain the allowance at a level that represents management's estimate of probable losses in the loan portfolio at the balance sheet date. Management's evaluation of the allowance is based on the Company's past loan loss experience, adverse circumstances that may affect the ability of borrowers to repay, the estimated value of collateral, and an analysis of the levels and trends of delinquencies, charge-offs, and the risk ratings of the various loan categories. Other factors such as the level and trend of interest rates and the condition of the national and local economies are also considered.

The allowance for loan losses is established through charges to earnings in the form of a provision for loan losses. When a loan or portion of a loan is determined to be uncollectible, the portion deemed uncollectible is charged against the allowance and subsequent recoveries, if any, are credited to the allowance.

A loan is considered impaired when, based on current information and events, it is probable that a creditor will be unable to collect all amounts of principal and interest under the original terms of the agreement. Accordingly, the Company evaluates impaired commercial and agricultural loans individually based on the present value of future cash flows discounted at the loan's effective interest rate, or at the loan's observable market price or the fair value of the collateral if the loan is collateral dependent. The Company collectively evaluates large groups of small balance, homogeneous loans for impairment including commercial and agricultural loans less than $250,000, all residential mortgages, home equity and consumer loans.

Federal Home Loan Bank (FHLB) Stock

As a member of the FHLB system, the Company is required to maintain a specified investment in FHLB stock. This non-marketable investment, which is carried at cost, must be at an amount at least equal to the greater of 5% of the outstanding advance balance or 1% of the aggregate outstanding residential mortgage loans held by the Company. Included in other assets is FHLB stock totaling $6.0 million and $6.3 million, at December 31, 2003 and 2002, respectively.

Premises and Equipment

Premises and equipment are stated at cost, less accumulated depreciation and amortization. Depreciation is computed using straight-line and accelerated methods over estimated useful lives of the assets. Leasehold improvements are amortized over the shorter of lease terms or the useful lives of the assets.

Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of net assets acquired in accordance with the purchase method of accounting for business combinations. Goodwill is not being amortized, but is required to be

tested for impairment at least annually. Other intangible assets are being amortized on the straight-line method, over the expected periods to be benefited. Intangible assets are periodically reviewed for impairment or when events or changed circumstances may affect the underlying basis of the assets.

Equity Method Investment

During 2002, the Company made a $2.4 million cash investment to acquire a 50% interest in Mercantile Adjustment Bureau, LLC, a full-service accounts receivable management firm located in Rochester, New York. The Company has accounted for this investment using the equity method and the investment is included in other assets on the consolidated statements of financial condition.

Stock Compensation

The Company uses a fixed award stock option plan to compensate certain key members of management of the Company and its subsidiaries. The Company accounts for issuance of stock options under the intrinsic value-based method of accounting prescribed by Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees." Under APB No. 25, compensation expense is recorded on the date the options are granted only if the current market price of the underlying stock exceeded the exercise price. SFAS No. 123, "Accounting for Stock-Based Compensation," established accounting and disclosure requirements using a fair value-based method of accounting for stock-based employee compensation plans. As allowed under SFAS No. 123, the Company has elected to continue to apply the intrinsic value-based method of accounting described above and has adopted only the disclosure requirements of SFAS No. 123, as amended by SFAS No. 148, "Accounting for Stock Based Compensation - Transition and Disclosure."

Pro forma disclosure for the years ended December 31, 2003, 2002 and 2001, utilizing the estimated fair value of the options granted under SFAS No. 123, is as follows:

(Dollars in thousands, except per share amounts)	Years ended December 31 2003	2002	2001
Reported net income	$ 14,247	$ 26,456	$ 21,213
Deduct: Total stock-based compensation expense determined under fair value based method for all awards, net of related tax effects	(336)	(274)	(288)
Pro forma net income	$ 13,911	$ 26,182	$ 20,925
Basic earnings per share:			
Reported	$ 1.14	$ 2.26	$ 1.79
Pro forma	$ 1.11	$ 2.23	$ 1.77
Diluted earnings per share:			
Reported	$ 1.13	$ 2.23	$ 1.77
Pro forma	$ 1.10	$ 2.20	$ 1.75

The weighted-average fair value of options granted during the years ended December 31, 2003, 2002, and 2001 amounted to $10.61, $11.90 and $5.53, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model and the following weighted-average assumptions:

	For the years ended December 31		
	2003	2002	2001
Dividend yield	2.89%	1.94%	2.43%
Expected life (in years)	10.00	10.00	10.00
Expected volatility	50.96%	38.14%	20.00%
Risk-free interest rate	3.96%	4.98%	4.99%

The Company's stock options have characteristics significantly different from those of traded options for which the Black-Scholes model was developed. Since changes in the subjective input assumptions can materially affect the fair value estimates, the existing model, in management's opinion, does not necessarily provide a single reliable measure of the fair value of its stock options. In addition, the pro forma effect on reported net income and earnings per share for the years ended December 31, 2003, 2002 and 2001, may not be representative of the pro forma effects on reported net income and earnings per share for future years.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and the respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates in effect for the year in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Financial Instruments With Off-Balance Sheet Risk

The Company's financial instruments with off-balance sheet risk are commercial letters of credit and mortgage, commercial and credit card loan commitments. These financial instruments are reflected in the statement of financial condition upon funding.

Financial Services Group Fees and Commissions and Trust Department Assets

Financial services group fees and commissions consist of commissions from sales of investment products and services to customers, fees and commissions from trust services provided to customers, and fees and commissions earned from design, consulting, administrative and actuarial services provided to employee benefits plans and their sponsors. Fees and commissions are recorded on the accrual basis of accounting. Assets held in fiduciary or agency capacities for customers are not included in the accompanying consolidated statements of condition, since such items are not assets of the Company.

New Accounting Pronouncements

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity." SFAS No. 150 requires that certain financial instruments, which under previous guidance could be accounted for as equity, be accounted for as liabilities. Financial instruments affected include mandatorily redeemable securities, certain financial instruments that require or may require the issuer to buy back some of its shares in exchange for cash or other assets and certain obligations that can be settled with shares of stock. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003 for all other financial instruments. The Company adopted the provisions of SFAS No. 150 on July 1, 2003. The adoption did not have a material impact on the Company's consolidated financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46 ("FIN 46"), "Consolidation of Variable Interest Entities". The objective of this interpretation is to provide guidance on how to identify a variable interest entities ("VIE") and determine when the assets, liabilities, non-controlling interests, and results of operations of a VIE need to be included in a company's consolidated financial statements. FIN 46 was effective for all VIEs created after January 31, 2003. However, the FASB postponed that effective date to December 31, 2003. In December 2003, the FASB issued a revised FIN 46 ("FIN 46R') which further delayed the effective date until March 31, 2004 for VIE's created prior to February 1, 2003. The requirements of FIN 46R resulted in the deconsolidation of the Company's wholly-owned subsidiary trust, formed to issue mandatorily redeemable preferred securities ("trust preferred securities"). The deconsolidation, as of December 31, 2003, results in the derecognition of the $16.2 million of trust preferred securities and the recognition of junior subordinated debentures of $16.7 million and investment in the subsidiary trust of $502,000 in the Company's 2003 consolidated statement of financial position.

In December 2003, the FASB issued SFAS No. 132, "Employers Disclosure about Pensions and Other Postretirement Benefits" to expand disclosure requirements to include descriptions of plan assets, investment strategy, measurement dates, plan obligations, cash flows and components of net periodic benefit cost recognized during interim periods. The Company adopted the provisions of SFAS No. 132, as revised, on December 31, 2003. The required disclosures are included in Note 12.

(2) Mergers and Acquisitions

On December 13, 2002, BNB acquired the two Chemung County branch offices of BSB Bank & Trust Company of Binghamton, New York. The two offices purchased, located in Elmira and Elmira Heights, had deposit liabilities totaling $44.2 million at the time of acquisition. The acquisition was accounted for as a business combination using the purchase method of accounting, and accordingly, the excess of the purchase price over the fair value of identifiable tangible and intangible assets acquired, less liabilities assumed, of approximately $1.5 million has been recorded as goodwill. In accordance with SFAS No. 142, the Company is not required to amortize goodwill. The Company also recorded a $2.0 million intangible asset attributable to core deposits, which is being amortized using the straight-line method over seven years.

On May 1, 2002, FII acquired all of the common stock of the Bank of Avoca ("BOA") in exchange for 47,036 shares of FII common stock. BOA was a community bank with its main office located in Avoca, New York, as well as a branch office in Cohocton, New York. Subsequent to the acquisition, BOA was merged with BNB. The acquisition was accounted for as a business combination using the purchase method of accounting, and accordingly, the excess of the purchase price ($1.5 million) over the fair value

of identifiable tangible and intangible assets acquired ($18.4 million), less liabilities assumed ($17.3 million), of approximately $0.4 million has been recorded as goodwill. In accordance with SFAS No. 142, the Company is not required to amortize goodwill recognized in this acquisition. The Company recorded a $146,000 core deposit intangible asset, which is being amortized using the straight-line method over seven years. The results of operations for BOA are included in the income statements from the date of acquisition (May 1, 2002).

On October 22, 2001, the Company acquired the Burke Group, Inc. ("BGI"); an employee benefits administration and compensation consulting firm, with offices in Honeoye Falls and Syracuse, New York. BGI's expertise includes design and consulting for retirement and employee welfare plans, administrative services for defined contribution and benefit plans, actuarial services and post employment benefits. The agreement provided for merger consideration of $1,500,000 to BGI shareholders. Merger consideration payments of $200,000 in cash and 34,452 shares of FII common stock (valued at $800,000 in accordance with merger agreement) were made on October 22, 2001. The balance of the merger consideration of $500,000 was paid on October 22, 2002 in the form of 18,852 shares of FII common stock as provided for in the agreement. In addition the agreement provided for the payment of earned amount consideration based on achievement of financial performance targets. For the period ending December 31, 2001 those targets were achieved and $500,000 in earned amount consideration was paid on April 1, 2002 in the form of 17,848 shares of FII common stock. For the period ending December 31, 2002 financial performance targets were also achieved and $750,000 in the form of 34,918 shares of FII common stock was paid on April 1, 2003. The agreement further provides for payment of contingent consideration in the form of FII common stock based on other financial performance targets for the periods ending December 31, 2002, 2003, and 2004 with the maximum amount of payment for 2004 being $2,500,000. For the year ended December 31, 2002 financial performance for contingent consideration was achieved and $590,000 was paid on April 1, 2003 in the form of 27,469 shares of FII common. For the year ended December 31, 2003 financial performance for contingent consideration was not achieved. The acquisition was accounted for as a business combination using the purchase method of accounting, and accordingly, the excess of the purchase price ($3.3 million including earned amounts and contingent amounts to date) over the fair value of identifiable tangible and intangible assets acquired ($1.7 million), less liabilities assumed ($1.7 million), of approximately $3.3 million has been recorded as goodwill. In accordance with SFAS No. 142, the Company is not required to amortize goodwill recognized in this acquisition. The Company also recorded a $500,000 intangible asset for a customer list that is being amortized using the straight-line method over five years. The results of operations for BGI are included in the income statements from the date of acquisition (October 22, 2001).

On May 1, 2001, the Company acquired all of the common stock of Bath National Corporation ("BNC"), and its wholly owned subsidiary bank, Bath National Bank. BNB is a full service community bank headquartered in Bath, New York, which has 9 branch locations in Steuben, Yates, Ontario and Schuyler Counties. The Company paid $48.00 per share in cash for each of the outstanding shares of BNC common stock with an aggregate purchase price of approximately $62.6 million. The acquisition was accounted for under the purchase method of accounting, and accordingly, the excess of the purchase price ($62.6 million) over the fair value of identifiable tangible and intangible assets acquired ($295.4 million), less liabilities assumed ($269.9 million), of approximately $37.1 million has been recorded as goodwill. Goodwill was amortized in 2001 using the straight-line method over 15 years, since the transaction was consummated prior to June 30, 2001, the effective date of SFAS No. 142. However, in accordance

with SFAS No. 142, the Company ceased goodwill amortization on January 1, 2002. The results of operations for BNB are included in the income statements from the date of acquisition (May 1, 2001).

(3) Securities

The aggregate amortized cost and fair value of securities available for sale and securities held to maturity follow:

	December 31, 2003			
		Gross Unrealized		
(Dollars in thousands)	Amortized Cost	Gains	Losses	
Securities Available for Sale:				
U.S. Treasury and agency	$ 210,570	$ 1,882	$ 583	$
Mortgage-backed securities	189,913	3,199	454	
State and municipal obligations	186,328	9,166	83	
Corporate bonds	4,020	70	--	
Equity securities	81	855	--	
Total securities available for sale	$ 590,912	$ 15,172	$ 1,120	$
Securities Held to Maturity:				
State and municipal obligations	$ 47,131	$ 1,006	$ 16	$
Total securities held to maturity	$ 47,131	$ 1,006	$ 16	$

	December 31, 2002			
		Gross Unrealized		
(Dollars in thousands)	Amortized Cost	Gains	Losses	
Securities Available for Sale:				
U.S. Treasury and agency	$ 117,581	$ 3,058	$ 13	$
Mortgage-backed securities	277,747	5,809	79	
State and municipal obligations	166,981	7,959	17	
Corporate bonds	13,775	203	55	
Equity securities	3,010	903	--	
Total securities available for sale	$ 579,094	$ 17,932	$ 164	$
Securities Held to Maturity:				
State and municipal obligations	$ 47,125	$ 969	$ 5	$

Total securities held to maturity	$ 47,125	$ 969	$ 5	$

Information on temporarily impaired securities at December 31, 2003, segregated according to the period of time such securities were in a continuous unrealized loss position, is summarized as follows:

	Less than 12 months		12 months or longer	
(Dollars in thousands)	Fair Value	Unrealized Losses	Fair Value	Unrealized Losses
Securities available for sale:				
U.S. Treasury and agency	$ 96,483	$ 583	$ --	$ --
Mortgage-backed securities	44,200	437	8,763	17
State and municipal obligations	7,582	83	--	--
Total securities available for sale	$ 148,265	$ 1,103	$ 8,763	$ 17

The table above represents 114 investment securities where the current fair value is less than the related amortized cost. These unrealized losses do not reflect any deterioration in the credit worthiness of the issuing securities and result primarily from fluctuations in market interest rates.

The amortized cost and fair value of debt securities by contractual maturity are as follows:

	December 31, 2003			
	Available for Sale		Held to Maturity	
(Dollars in thousands)	Amortized Cost	Fair Value	Amortized Cost	Fair Value
Due in one year or less	$ 56,325	$ 56,690	$ 33,458	$ 33,574
Due in one to five years	153,950	160,617	10,654	11,241
Due in five to ten years	189,868	194,962	2,220	2,423
Due after ten years	190,688	191,759	799	883
	$ 590,831	$ 604,028	$ 47,131	$ 48,121

Maturities of mortgage-backed securities are classified in accordance with the

contractual repayment schedules. Expected maturities will differ from contractual maturities since issuers generally have the right to prepay obligations.

Proceeds from the sale and call of securities during 2003 were $82,906,000; realized gross gains were $1,042,000 and gross losses were $1,000. Proceeds from the sale and call of securities during 2002 were $45,059,000; realized gross gains were $615,000 and gross losses were $330,000. Proceeds from the sale and call of securities during 2001 were $91,412,000; realized gross gains were $617,000 and gross losses were $86,000. Gains and losses were computed using the specific identification method. There were no transfers between held to maturity and available for sale securities in 2003, 2002 or 2001.

Securities held to maturity and available for sale with carrying values of $465,083,000 and $475,567,000 were pledged as collateral for municipal deposits and repurchase agreements at December 31, 2003 and 2002, respectively.

(4) Loans

Loans outstanding at December 31, 2003 and 2002 are summarized as follows:

(Dollars in thousands)	2003	2002
Commercial	$ 248,313	$ 262,630
Commercial real estate	369,712	332,134
Agricultural	235,199	233,769
Residential real estate	251,502	251,898
Consumer and home equity	240,591	241,461
Loans, gross	1,345,317	1,321,892
Allowance for loan losses	(29,064)	(21,660)
Loans, net	$ 1,316,253	$ 1,300,232

The following table sets forth the changes in the allowance for loan losses for the years indicated.

	Years ended December 31		
(Dollars in thousands)	2003	2002	2001
Balance at beginning of year	$21,660	$19,074	$13,883
Addition resulting from acquisitions	--	174	2,686
Charge-offs:			
Commercial	8,891	1,771	1,003
Commercial real estate	2,953	944	394
Agricultural	1,876	106	58
Residential real estate	215	98	178
Consumer and home equity	2,107	1,499	1,319
Total charge-offs	16,042	4,418	2,952

Recoveries:			
Commercial	525	210	58
Commercial real estate	35	69	23
Agricultural	3	36	--
Residential real estate	11	67	19
Consumer and home equity	346	329	399
Total recoveries	920	711	499
Net charge-offs	15,122	3,707	2,453
Provision for loan losses	22,526	6,119	4,958
Balance at end of year	$29,064	$21,660	$19,074

The following table sets forth information regarding nonaccrual loans and other nonperforming assets at December 31:

(Dollars in thousands)	2003	2002
Nonaccrual loans:		
Commercial	$12,983	$12,760
Commercial real estate	11,745	8,407
Agricultural	18,870	8,739
Residential real estate	2,496	1,065
Consumer and home equity	578	915
Total nonaccrual loans	46,672	31,886
Restructured loans	3,069	4,129
Accruing loans 90 days or more delinquent	1,709	1,091
Total nonperforming loans	51,450	37,106
Other real estate owned	653	1,251
Total nonperforming assets	$52,103	$38,357

The recorded investment in impaired loans that have been evaluated individually for impairment totaled $21,990,000 and $24,626,000 at December 31, 2003 and 2002, respectively. The allowance for loan losses related to impaired loans amounted to $4,324,000 and $4,462,000 at December 31, 2003 and 2002, respectively. The average recorded investment in impaired loans during 2003, 2002 and 2001 was $28,650,000, $25,332,000 and $10,842,000, respectively. Interest income recognized on impaired loans, while such loans were impaired, during 2003, 2002 and 2001 was approximately $218,000, $455,000 and $392,000, respectively.

In the normal course of business there are various outstanding commitments to extend credit that are not reflected in the accompanying consolidated financial

statements. Loan commitments have off-balance-sheet credit risk until commitments are fulfilled or expire. The credit risk amounts are equal to the contractual amounts, assuming that the amounts are ultimately advanced in full and that the collateral or other security is of no value. The Company's policy generally requires customers to provide collateral, usually in the form of customers' operating assets or property, prior to the disbursement of approved loans. At December 31, 2003, letters of credit totaling $11,789,000 and unused loan commitments and lines of credit of $271,874,000 were contractually available. Comparable amounts for these letters of credit and commitments at December 31, 2002 were $13,359,000 and $316,595,000, respectively. Commitments generally have fixed expiration dates or other termination clauses and may require payment of a fee. Since many of the commitments are expected to expire without funding, the total commitment amounts do not necessarily represent future cash requirements.

Loans outstanding by subsidiary banks to certain officers, directors, or companies in which they have 10% or more beneficial ownership, including officers and directors of the Company, as well as its subsidiaries ("Insiders"), approximated $25,651,000 and $36,406,000 at December 31, 2003 and 2002, respectively.

An analysis of activity with respect to insider loans during the year ended December 31, 2003 is as follows:

(Dollars in thousands)

Balance as of December 31, 2002	$ 36,406
New loans to insiders	3,913
Repayments received from insiders	(1,063)
Other changes *	(13,605)
Balance as of December 31, 2003	$ 25,651

* Other changes relate primarily to changes in director status during 2003.

These loans were made on substantially the same terms, including interest rate and collateral, as comparable transactions with other customers.

As of December 31, 2003, the Company had no significant concentration of credit risk in the loan portfolio other than normal geographic concentration pertaining to the communities that the Company serves and the dairy industry in Western, New York. At December 31, 2003, the Company had $119.3 million, or 8.9% of the portfolio, in loans to borrowers operating in the dairy industry, of which $16.5 million, or 13.8% were in nonperforming status. There is no significant exposure to highly leveraged transactions and there are no foreign credits in the loan portfolio.

Loans serviced for others amounting to $439,450,000 and $356,419,000 at December 31, 2003 and 2002, respectively, are not included in the consolidated statements of financial condition. The Company had capitalized mortgage servicing rights of $2,073,000 and $1,243,000 as of December 31, 2003 and 2002, respectively. Proceeds from the sale of loans were $192,295,000, $139,426,000 and $117,446,000 in 2003, 2002 and 2001, respectively. Net gain on the sale of loans included in mortgage banking activities on the income statement, was $3,153,000, $1,542,000 and $1,513,000 in 2003, 2002 and 2001, respectively. Included in net loans are loans held for sale totaling $4,881,000 and $6,971,000 at December 31, 2003 and 2002, respectively. The Company enters into forward contracts for future delivery of residential mortgage loans at a specified yield to reduce the interest rate risk associated with fixed rate residential mortgage loans held

for sale and commitments to fund residential mortgages. Credit risk arises from the possible inability of the other parties to comply with the contract terms. Substantially all of the Company's contracts are with government-sponsored enterprises or government agencies (FHLMC and FHA).

(5) Premises and Equipment

A summary of premises and equipment at December 31, 2003 and 2002 follows:

(Dollars in thousands)	2003	2002
Land and land improvements	$ 4,101	$ 3,320
Buildings and leasehold improvements	29,946	24,275
Furniture, fixtures, equipment and vehicles	22,833	19,129
Premises and equipment, gross	56,880	46,724
Accumulated depreciation and amortization	(22,641)	(19,470)
Premises and equipment, net	$ 34,239	$ 27,254

Depreciation and amortization expense amounted to $3,434,000, $2,879,000 and $2,403,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

(6) Goodwill and Other Intangible Assets

As discussed in Note 1, the Company adopted the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets," on January 1, 2002. Under SFAS No. 142, goodwill is no longer amortized, but is reviewed for impairment at least annually. Identifiable intangible assets acquired in a business combination are amortized over their useful lives.

The following table presents the pro forma effects of applying the non-amortization provisions of SFAS No. 142 to the results of operations for 2001. There was no impact to the results of operations for 2003 and 2002.

	Years ended December 31		
(Dollars in thousands, except per share amounts)	2003	2002	2001
Reported net income	$ 14,247	$ 26,456	$ 21,213
Goodwill amortization add-back	--	--	1,653
Adjusted net income	$ 14,247	$ 26,456	$ 22,866
Basic earnings per share:			
Reported	$ 1.14	$ 2.26	$ 1.79
Goodwill amortization add-back	--	--	0.15
Adjusted	$ 1.14	$ 2.26	$ 1.94

Diluted earnings per share:			
Reported	$ 1.13	$ 2.23	$ 1.77
Goodwill amortization add-back	--	--	0.15
Adjusted	$ 1.13	$ 2.23	$ 1.92

Goodwill resulting from the previously disclosed mergers and acquisitions (see Note 2) amounted to $40.6 million at December 31, 2003 and 2002. Goodwill amortization expense included in the results of operations for 2001 amounted to $1.7 million, which was non-deductible for income tax purposes. In accordance with SFAS No. 142, there is no goodwill amortization included in 2003 or 2002.

The following table presents the change in the carrying amount of goodwill allocated by business segment for the years ended December 31, 2003 and 2002:

(Dollars in thousands)	BNB Segment	Financial Services Group Segment	Total
Balance as of December 31, 2001	$ 35,535	$1,294	$ 36,829
Goodwill acquired during the period	1,925	--	1,925
Contingent earnout	--	1,840	1,840
Goodwill adjustments	(119)	118	(1)
Balance as of December 31, 2002	$ 37,341	$3,252	$ 40,593
Goodwill adjustments	28	--	28
Balance as of December 31, 2003	$ 37,369	$3,252	$ 40,621

During 2003, in accordance with SFAS No. 142, the Company evaluated goodwill for impairment using a discounted cash flow analysis and determined no impairment existed.

A summary of the major classes of amortizable intangible assets (included in other assets on the consolidated statements of financial condition) at December 31, 2003 and 2002 follows:

(Dollars in thousands)	2003	2002
Core deposits	$ 11,452	$ 11,452
Customer list	500	500
Other intangible assets, gross	11,952	11,952
Accumulated amortization	(9,224)	(7,998)
Other intangible assets, net	$ 2,728	$ 3,954

Intangible amortization expense for these other intangible assets amounted to $1,226,000, $898,000 and $728,000 for the years ended December 31, 2003, 2002 and 2001, respectively. Amortization of other intangible assets was computed using the straight-line method over the estimated lives of the respective assets (primarily 5 and 7 years). Based on the current level of intangible assets, estimated amortization expense for other intangible assets is as follows:

Year ending December 31,
(Dollars in thousands)

2004	$ 809
2005	530
2006	498
2007	303
2008	307
Thereafter	281
	$ 2,728

(7) Deposits

Scheduled maturities for certificates of deposit at December 31, 2003 are as follows:

Mature in year ending December 31,
(Dollars in thousands)

2004	$525,547
2005	165,348
2006	31,243
2007	26,152
2008	21,034
Thereafter	358
	$769,682

Certificates of deposit greater than $100,000 totaled $267,116,000 and $201,751,000 at December 31, 2003 and 2002, respectively. Interest expense on certificates of deposit greater than $100,000 amounted to $6,846,000, $7,682,000 and $15,922,000 for the years ended December 31, 2003, 2002 and 2001, respectively.

As of December 31, 2003 and 2002, overdrawn deposits included in loans on the consolidated statements of financial condition amounted to $1,054,000 and $3,459,000, respectively.

(8) Borrowings

Outstanding borrowings at December 31, 2003 and 2002 are summarized as follows:

(Dollars in thousands)	2003	2002

Short-term borrowings:		
Federal funds purchased and securities sold under repurchase agreements	$22,525	$60,679
FHLB advances	26,500	26,000
Other	1,000	510
Total short-term borrowings	$50,025	$87,189
Long-term borrowings:		
FHLB advances	$62,469	$86,822
Other	25,051	5,268
Total long-term borrowings	$87,520	$92,090

Information related to Federal funds purchased and securities sold under repurchase agreements as of and for the years ended December 31, 2003, 2002 and 2001 is summarized as follows:

(Dollars in thousands)	2003	2002	2001
Weighted average interest rate at year-end	0.89%	1.50%	1.88%
Maximum outstanding at any month-end	$36,414	$61,951	$65,474
Average amount outstanding during the year	$30,284	$47,924	$33,157

The average amounts outstanding are computed using daily average balances. Related interest expense for 2003, 2002 and 2001 was $376,000, $951,000 and $1,108,000, respectively.

At December 31, 2003, the Company had outstanding various short and long-term FHLB advances with maturity dates extending through 2014. The FHLB advances bear interest at fixed rates ranging from 2.41% to 7.80% and the weighted average interest rate amounted to 4.47% as of December 31, 2003.

The Company's FHLB advances include $20.0 million in fixed-rate callable borrowings, which can be called by the FHLB on a quarterly basis. FHLB advances are collateralized by $6.0 million of FHLB stock, mortgage loans with a carrying value of $84.2 million at December 31, 2003 and investment securities with a fair market value of $37.8 million at December 31, 2003. At December 31, 2003, the Company had remaining credit available of $27.8 million under lines of credit with the FHLB. The Company also had $74.3 million of remaining credit available under unsecured lines of credit with various banks at December 31, 2003. The Company also has available lines of credit with Farmer Mac permitting borrowings to a maximum of $25.0 million. Advances outstanding against the Farmer Mac lines at December 31, 2003 amounted to $1.0 million.

During 2003, FII expanded the terms of an existing credit agreement with M&T Bank and infused approximately $15 million of the financing proceeds as capital to the NBG and BNB subsidiaries allowing those banks to meet higher capital ratios required in agreements imposed by their regulator. The credit agreement includes a $25.0 million term loan facility and a $5.0 million revolving loan facility. The term loan requires monthly payments of interest only, at a variable interest rate of London Interbank Offered Rate ("LIBOR") plus 1.75%, which was 2.98% as of December 31, 2003. The $25.0 million term loan is included

in long-term borrowings on the consolidated statements of financial condition as principal installments are due as follows: $5.0 million in December 2006, $10.0 million in December 2007 and $10.0 million in December 2008. The $5.0 million revolving loan accrues interest at a rate of LIBOR plus 1.50%. There were no advances outstanding on the revolving loan as of December 31, 2003. The credit agreement includes affirmative financial covenants, all of which were met as of December 31, 2003. FII pledged the stock of its subsidiary banks as collateral for the credit facility.

The aggregate maturities of long-term borrowings at December 31, 2003 are as follows:

Mature in year ending December 31,
(Dollars in thousands)

2005	$ 7,282
2006	15,139
2007	14,098
2008	30,232
2009	20,529
Thereafter	240
	$ 87,520

(9) Trust Preferred Securities and Junior Subordinated Debentures

On February 22, 2001, the Company established FISI Statutory Trust I (the "Trust"), which is a statutory business trust formed under Connecticut law. The Trust exists for the exclusive purposes of (i) issuing and selling 30 year guaranteed preferred beneficial interests in the trust assets ("trust preferred" or "capital" securities) in the aggregate amount of $16.2 million at a fixed rate of 10.20%, (ii) using the proceeds from the sale of the capital securities to acquire the junior subordinated debentures issued by the Company and (iii) engaging in only those other activities necessary, advisable or incidental thereto.

The Company's junior subordinated debentures are the primary assets of the Trust and, accordingly, payments under the corporation obligated junior debentures are the sole revenue of the Trust. The capital securities of the Trust are non-voting. The Company owns all of the common securities of the Trust. The Company used the net proceeds from the sale of the capital securities to partially fund the BNB acquisition. The capital securities qualified as Tier 1 capital under regulatory definitions as of December 31, 2003 and 2002.

The Company's primary sources of funds to pay interest on the debentures held by the Trust are current dividends from its subsidiary banks. Accordingly, the Company's ability to service the debentures is dependent upon the continued ability of the subsidiary banks to pay dividends to the Company. Since the junior subordinated obligations and trust preferred securities at December 31, 2003 and 2002,

respectively are classified as debt for financial statement purposes, the associated tax-deductible expense has been recorded as interest expense in the consolidated statements of income.

The Company incurred $487,000 in costs to issue the securities and the costs are

being amortized over 20 years using the straight-line method

As of December 31, 2003, the Company deconsolidated the subsidiary Trust, which had issued trust preferred securities, and replaced the presentation of such instruments with the Company's junior subordinated debentures issued to the subsidiary Trust. Such presentation reflects the adoption of FASB Interpretation No. 46 ("FIN 46 R"), "Consolidation of Variable Interest Entities."

(10) Income Taxes

Total income taxes for the years ended December 31, 2003, 2002 and 2001 were allocated as follows:

(Dollars in thousands)	2003	2002	2001
Income from operations	$ 3,977	$ 12,419	$ 11,033
Additional paid-in capital for stock options exercised	(87)	(148)	--
Shareholders' equity for unrealized gain (loss) on securities available for sale	(1,535)	5,488	1,588
	$ 2,355	$ 17,759	$ 12,621

Income tax expense (benefit) attributable to operations for the years ended December 31, 2003, 2002 and 2001 consists of:

(Dollars in thousands)	2003	2002	2001
Current:			
Federal	$ 5,245	$ 10,828	$ 8,676
State	703	2,651	2,469
Total current	5,948	13,479	11,145
Deferred:			
Federal	(1,909)	(908)	(68)
State	(62)	(152	(44)
Total deferred	(1,971)	(1,060)	(112)
Total income taxes	$ 3,977	$ 12,419	$ 11,033

The following is a reconciliation of the actual and statutory tax rates applicable to income from operations for the years ended December 31, 2003, 2002 and 2001:

	2003	2002	2001
Statutory rate	35.0%	35.0%	35.0%

Increase (decrease) resulting from:			
Tax exempt interest income	(16.3)	(7.8)	(8.1)
State taxes, net of federal income tax benefit	2.3	4.2	4.9
Goodwill amortization	--	--	1.8
Other	0.8	0.5	0.6
Total	21.8%	31.9%	34.2%

The tax effects of temporary differences that give rise to the deferred tax assets and deferred tax liabilities at December 31, 2003 and 2002 are presented as follows:

(Dollars in thousands)	2003	2002
Deferred tax assets:		
Allowance for loan losses	$ 11,106	$ 8,216
Core deposit intangible	965	822
Interest on nonaccrual loans	1,178	869
Other	1,106	946
Total gross deferred tax assets	14,355	10,853
Deferred tax liabilities:		
Prepaid pension costs	1,046	1,017
Unrealized gain on securities available for sale	5,441	6,976
Depreciation of premises and equipment	1,591	917
Loan servicing assets	826	479
Other	1,178	697
Total gross deferred tax liabilities	10,082	10,086
Net deferred tax asset, at year-end *	$ 4,273	$ 767
Net deferred tax asset, at beginning of year	767	4,922
Decrease (increase) in net deferred tax asset	(3,506)	4,155
Net deferred tax asset acquired	--	368
Initial purchase accounting adjustments, net	--	(95)
Change in unrealized gain/loss on securities available for sale	1,535	(5,488)
Deferred tax benefit	$ (1,971)	$ (1,060)

* Included in other assets on the consolidated statements of financial condition

Realization of deferred tax assets is dependent upon the generation of future taxable income or the existence of sufficient taxable income within the carry-back period. A valuation allowance is provided when it is more likely than not that some portion of the deferred tax assets will not be realized. In assessing the need for a valuation allowance, management considers the scheduled reversal of the deferred tax liabilities, the level of historical taxable income and projected future taxable income over the periods in which the temporary differences comprising the deferred tax assets will be deductible. Based on its assessment, management determined that no valuation allowance is necessary at December 31, 2003 and 2002.

The Company has Federal and state net operating loss carryforwards of $434,000 that expire in 2021. The utilization of the tax net operating carryforwards is subject to limitations imposed by the Internal Revenue Code. The Company believes these limitations will not prevent the carryforward benefits from being utilized.

(11) Lease Commitments

At December 31, 2003, the Company was obligated under a number of noncancellable operating leases for land, buildings and equipment. Certain of these leases provide for escalation clauses and contain renewal options calling for increased rentals if the lease is renewed. Future minimum lease payments on operating leases at December 31, 2003 were as follows:

Operating lease payments in year ending December 31,
(Dollars in thousands)

2004	$ 651
2005	591
2006	514
2007	484
2008	458
Thereafter	2,842
	$ 5,540

(12) Retirement Plans and Postretirement benefits

Defined Benefit Plan

The Company participates in The New York State Bankers Retirement System, which is a defined benefit pension plan covering substantially all employees. The benefits are based on years of service and the employee's highest average compensation during five consecutive years of employment. The Company's funding policy is to contribute annually an actuarially determined amount to cover current service cost plus amortization of prior service costs.

The following table sets forth the defined benefit pension plan's change in benefit obligation and change in plan assets using the most recent actuarial data measured at September 30:

(Dollars in thousands)	2003	2002	2001
Change in benefit obligation:			
Benefit obligation at beginning of year	$(16,282)	$(13,608)	$(12,114)
Service cost	(1,282)	(1,071)	(1,249)
Interest cost	(1,079)	(968)	(890)
Actuarial (loss) gain	(2,136)	(1,303)	72
Benefits paid	590	559	470
Plan expenses	109	109	103
Benefit obligation at end of year	(20,080)	(16,282)	(13,608)
Change in plan assets:			
Fair value of plan assets at beginning of year	14,294	15,240	17,180
Actual (loss) return on plan assets	2,544	(830)	(1,367)
Employer contributions	1,421	552	--
Benefits paid	(590)	(559)	(470)
Plan expenses	(109)	(109)	(103)
Fair value of plan assets at end of year	17,560	14,294	15,240
Funded status	(2,520)	(1,988)	1,632
Unamortized net asset at transition	(103)	(141)	(179)
Unrecognized net loss subsequent to transition	5,362	4,722	1,292
Unamortized prior service cost	231	322	345
Prepaid benefit cost, included in other assets	$ 2,970	$ 2,915	$ 3,090

Net periodic pension cost consists of the following components for the years ended December 31:

(Dollars in thousands)	2003	2002	2001
Service cost	$ 1,351	$ 1,071	$ 850
Interest cost on projected benefit obligation	1,079	968	890
Expected return on plan assets	(1,251)	(1,297)	(1,429)
Amortization of net transition asset	(38)	(38)	(38)
Amortization of unrecognized loss	201	--	--
Amortization of unrecognized prior service cost	22	22	(3)
Net periodic pension cost	$ 1,364	$ 726	$ 270

Weighted-average assumptions used to determine the net periodic pension cost for the years ended December 31:

	2003	2002	2001

Weighted average discount rate	6.00%	6.75%	7.25%
Expected long-term rate of return	8.00%	8.50%	8.50%
Rate of compensation increase	3.00%	4.00%	5.00%

The expected long-term rate-of-return on plan assets reflects long-term earnings expectations on existing plan assets and those contributions expected to be received during the current plan year. In estimating that rate, appropriate consideration was given to historical returns earned by plan assets in the fund and the rates of return expected to be available for reinvestment. Average rates of return over the past 1,3,5 and 10 year periods were determined and subsequently adjusted to reflect current capital market assumptions and changes in investment allocations.

The pension plan weighted-average asset allocations at September 30, 2003 and 2002, by asset category are as follows:

(Dollars in thousands)	2003	2002
Asset category:		
Equity securities	59.7%	55.3%
Debt securities	34.5	36.3
Other	5.8	8.4
Total	100.0%	100.0%

The New York State Bankers Retirement System (the "System") was established in 1938 to provide for the payment of benefits to employees of participating banks. A Board of Trustees meets quarterly to set the investment policy guidelines and oversee the System.

The System utilizes two investment management firms, (which will be referred to as Firm I and Firm II) each investing approximately 50% of the total portfolio. The System's investment objective is to exceed the investment benchmarks in each asset category. Each firm operates under a separate written investment policy approved by the Trustees and designed to achieve an allocation approximating 60% invested in equity securities and 40% invested in debt securities.

Each Firm reports at least quarterly to the Investment Committee and semi-annually to the Board.

Equities: The target allocation percentage for equity securities is 60% but may vary from 50%-70% at the investment manager's discretion.

Fixed Income: For both investment portfolios, the target allocation percentage for debt securities is 40% but may vary from 30%-50% at the investment manager's discretion.

The Company expects to contribute approximately $1,406,000 to the pension plan prior to June 15, 2004.

Defined Contribution Plan

The Company also sponsors a defined contribution profit sharing (401(k)) plan

covering substantially all employees. The Company matches certain percentages of each eligible employee's contribution to the plan. Expense for the plan amounted to $299,000, $1,057,000 and $708,000 in 2003, 2002 and 2001, respectively.

Postretirement Benefits

Prior to December 31, 2001, BNB provided health and dental care benefits to retired employees who met specified age and service requirements through a postretirement health and dental care plan in which both BNB and the retiree shared the cost. The plan provided for substantially the same medical insurance coverage as for active employees until their death and was integrated with Medicare for those retirees aged 65 or older. In 2001, the plan's eligibility requirements were amended to curtail eligible benefit payments to only retired employees and active participants who were fully vested under the Plan. In 2003, retirees under age 65 began contributing to health coverage at the same cost-sharing level as that of active employees. The retirees aged 65 or older were offered new Medicare supplemental plans as alternatives to the plan historically offered. The cost sharing of medical coverage was standardized throughout the group of retirees aged 65 or older. In addition, to be consistent with the administration of the Company's dental plan for active employees, all retirees who continued dental coverage began paying the full monthly premium. The accrued liability related to this plan amounted to $828,000 and $844,000 as of December 31, 2003 and 2002, respectively. Expense for the plan amounted to $108,000 and $172,000 for the years ended December 31, 2003 and 2002, respectively.

(13) Stock Compensation Plans

The Company has a Management Stock Incentive Plan and a Directors' Stock Incentive Plan. Under the plans, the Company may grant stock options to its directors, directors of its subsidiaries, and key employees to purchase shares of common stock, shares of restricted stock and stock appreciation rights. Grants under the plans may be made to up to 10% of the number of shares of common stock issued, including treasury shares. The exercise price of each option equals the market price of the Company's stock on the date of the grant. The maximum term of each option is ten years and the options' generally vest between three and five years.

The following is a summary of the status of the Company's stock option plans as of December 31, 2003, 2002 and 2001, as well as changes in the plans during the years then ended:

	Stock Options Outstanding	Weighted Average Exercise Price
Balance December 31, 2000	$ 384,518	$ 13.90
Granted	115,637	18.94
Cancelled	(3,474)	(13.65)
Balance December 31, 2001	$ 496,681	$ 15.08
Granted	52,353	27.41
Exercised	(19,955)	(13.95)
Cancelled	(74,792)	(13.99)

Balance December 31, 2002	454,287	16.73
Granted	65,831	22.16
Exercised	(21,669)	(14.30)
Cancelled	(66,173)	(15.31)
Balance December 31, 2003	$ 432,276	$ 17.89
Exercisable at:		
December 31, 2003	$ 260,225	$ 15.83
December 31, 2002	224,284	14.75
December 31, 2001	153,826	13.92

The following table summarizes information about stock options outstanding and exercisable at December 31, 2003:

	Outstanding			Exercisa
Range of Exercise Price	Number of Stock Options	Weighted Average Exercise Price	Weighted Average Life (in years)	Number of Stock Options
$11.75 to $14.13	253,146	$ 13.91	5.72	208,159
$20.50 to $22.50	80,400	21.57	7.89	31,923
$22.51 to $25.00	50,772	22.75	8.96	4,002
$25.33 to $26.45	38,041	25.48	8.16	12,838
$33.15 to $36.00	9,917	35.74	8.36	3,303
	432,276	$ 17.89	6.78	260,225

(14) Earnings Per Common Share

Basic earnings per share, after giving effect to preferred stock dividends, has been computed using weighted average common shares outstanding. Diluted earnings per share reflect the effects, if any, of incremental common shares issuable upon exercise of dilutive stock options.

Earnings per common share have been computed based on the following:

	Years Ended December 31		
(Dollars and shares in thousands)	2003	2002	2001
Net income	$ 14,247	$ 26,456	$ 21,213
Less: Preferred stock dividends	1,495	1,496	1,496

Net income available to common shareholders	$ 12,752	$ 24,960	$ 19,717
Weighted average number of common shares outstanding used to calculate basic earnings per common share	11,148	11,068	10,994
Add: Effect of dilutive options	98	150	132
Weighted average number of common shares used to calculate diluted earnings per common share	11,246	11,218	11,126

(15) Regulatory Capital

The Company is subject to various regulatory capital requirements administered by the Federal banking agencies. Failure to meet minimum capital requirements can initiate certain mandatory, and possibly additional discretionary, actions by regulators that, if undertaken, could have a direct material impact on the Company's financial statements.

For evaluating regulatory capital adequacy, companies are required to determine capital and assets under regulatory accounting practices. Quantitative measures established by regulation to ensure capital adequacy require the Company to maintain minimum amounts and ratios. The leverage ratio requirement is based on period-end capital to average total assets during the previous three months. Compliance with risk-based capital requirements is determined by dividing regulatory capital by the sum of a company's weighted asset values. Risk weightings are established by the regulators for each asset category according to the perceived degree of risk. As of December 31, 2003 and 2002, the Company and each subsidiary bank met all capital adequacy requirements to which they are subject.

As of December 31, 2003, the most recent notification from the Federal Deposit Insurance Corporation ("FDIC") categorized the Company and its subsidiary banks as well capitalized under the regulatory framework for prompt corrective action. For purposes of determining the annual deposit insurance assessment rate for insured depository institutions, each insured institution is assigned an assessment risk classification. Each institution's assigned risk classification is composed of a group and subgroup assignment based on capital group and supervisory subgroup. Although the NBG and BNB subsidiaries remain assigned to the well capitalized capital group, these two subsidiaries received notification of a downgrade in supervisory subgroup based on the formal agreements in place with the OCC.

Payments of dividends by the subsidiary banks to FII are limited or restricted in certain circumstances under banking regulations. At December 31, 2003, an aggregate of $13,233,000 was available for payment of dividends by the subsidiary banks to FII without the approval from the appropriate regulatory authorities.

The following is a summary of the actual capital amounts and ratios for the Company and its subsidiary banks as of December 31:

	2003				
	Actual Regulatory Capital		Minimum Requirements		Well-C
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount
Leverage capital (Tier 1) as percent of three-month average assets:					
Company	$ 147,722	7.03%	$ 84,082	4.00%	$ 105,103
BNB	34,202	8.02	17,065	4.00	21,332
FTB	13,550	6.09	8,901	4.00	11,126
NBG	58,593	8.04	29,162	4.00	36,452
WCB	48,215	6.71	28,738	4.00	35,923
As percent of risk-weighted, period-end assets: Core capital (Tier 1):					
Company	147,722	10.18	58,033	4.00	87,050
BNB	34,202	13.69	9,995	4.00	14,993
FTB	13,550	10.90	4,971	4.00	7,456
NBG	58,593	11.15	21,027	4.00	31,540
WCB	48,215	8.91	21,655	4.00	32,483
Total capital (Tiers 1 and 2):					
Company	165,992	11.44	116,067	8.00	145,084
BNB	37,343	14.94	19,991	8.00	24,989
FTB	15,108	12.16	9,942	8.00	12,427
NBG	65,233	12.41	42,053	8.00	52,566
WCB	55,027	10.16	43,310	8.00	54,138

	2002				
	Actual Regulatory Capital		Minimum Requirements		Well-Ca
(Dollars in thousands)	Amount	Ratio	Amount	Ratio	Amount
Leverage capital (Tier 1) as percent of three-month average assets:					
Company	$ 139,620	6.96%	$ 80,233	4.00%	$ 100,292
BNB	24,505	5.93	16,527	4.00	20,658
FTB	11,356	5.67	8,017	4.00	10,022
NBG	48,420	6.71	28,870	4.00	36,087
WCB	44,175	6.64	26,592	4.00	33,240
As percent of risk-weighted, period-end assets: Core capital (Tier 1):					
Company	139,620	9.82	56,846	4.00	85,270
BNB	24,505	9.70	10,110	4.00	15,165
FTB	11,356	9.45	4,807	4.00	7,210
NBG	48,420	8.90	21,758	4.00	32,637
WCB	44,175	8.94	19,761	4.00	29,642
Total capital (Tiers 1 and 2):					
Company	157,433	11.08	113,693	8.00	142,116
BNB	27,669	10.95	20,220	8.00	25,275
FTB	12,861	10.70	9,613	8.00	12,017
NBG	55,243	10.16	43,515	8.00	54,394
WCB	50,369	10.20	39,522	8.00	49,403

The formal agreements entered into by NBG and BNB with their primary regulator

required both banks to develop capital plans enabling them to achieve, by March 31, 2004, a Tier 1 leverage capital ratio equal to 8%, a Tier 1 risk-based capital ratio equal to 10%, and a total risk-based capital ratio of 12%. As indicated in the table above, each of the banks meets the required levels at December 31, 2003.

(16) Fair Value of Financial Instruments

The "fair value" of a financial instrument is defined as the price a willing buyer and a willing seller would exchange in other than a distressed sale situation. The following table presents the carrying amounts and estimated fair values of the Company's financial instruments at December 31, 2003 and 2002:

	2003		2002	
(Dollars in thousands)	Carrying Amount	Fair Value	Carrying Amount	Fair Value
Financial Assets				
Cash and cash equivalents	$ 45,635	$ 45,635	$ 48,429	$ 48,4
Securities	652,095	653,085	643,987	644,9
FHLB and FRB stock	8,351	8,351	8,558	8,5
Loans, net	1,316,253	1,355,654	1,300,232	1,345,3
Financial Liabilities				
Deposits:				
Interest Bearing:				
Savings and interest bearing demand	784,219	784,219	779,772	779,7
Time deposits	769,682	769,682	687,996	691,0
Non-interest bearing demand	264,990	264,990	240,755	240,7
Total deposits	1,818,891	1,818,891	1,708,523	1,711,5
Borrowings:				
Short-term	50,025	50,223	87,189	88,0
Long-term	87,520	86,635	92,090	101,7
Junior subordinated debentures	16,702	19,959	--	
Trust preferred securities	--	--	16,200	19,0

The following methods and assumptions were used to estimate the fair value of each class of financial instruments.

Cash and cash equivalents: The carrying amounts reported in the consolidated statements of financial condition for cash, due from banks, interest-bearing deposits and Federal funds sold approximate the fair value of those assets.

Securities: Fair value is based on quoted market prices, where available. Where quoted market prices are not available, fair value is based on quoted market prices of comparable instruments.

FHLB and FRB stock: The carrying amounts reported in the consolidated statements of financial condition for FHLB and FRB stock approximate the fair value of those assets.

Loans: For variable rate loans that reprice frequently, fair value approximates carrying amount. The fair value for fixed rate loans is estimated through discounted cash flow analysis using interest rates currently being offered on loans with similar terms and credit quality. The fair value of loans held for sale is based on quoted market prices and investor commitments. For nonperforming loans, fair value is estimated by discounting expected cash flows at a rate commensurate with the risk associated with the estimated cash flows.

Deposits: The fair value for savings, interest bearing and non-interest bearing demand accounts is equal to the carrying amount because of the customer's ability to withdraw funds immediately. The fair value of time deposits is estimated using a discounted cash flow approach that applies prevailing market interest rates for similar maturity instruments.

Borrowings: Carrying value approximates fair value for short-term borrowings. The fair value for long-term borrowings is estimated using a discounted cash flow approach that applies prevailing market interest rates for similar maturity instruments.

Junior subordinated debentures and trust preferred securities: The fair value for the junior subordinated debentures is estimated using a discounted cash flow approach that applies prevailing market interest rates for similar maturity instruments.

(17) Segment Information

Reportable segments are comprised of WCB, NBG, BNB and FTB as the Company evaluates performance on an individual bank basis. As stated in Note 1, during 2002 the Company completed a geographic realignment of the subsidiary banks, which involved the merger of the subsidiary formerly known as PSB into NBG and subsequent transfer of branches between NBG and WCB. Accordingly, the Company restated segment results to reflect the merger and transfers for each of the years presented. All of the revenue, expenses, assets and liabilities of PSB have been reallocated to the WCB and NBG segments. The reportable segment information as of and for the years ended December 31, 2003, 2002 and 2001 follows:

(Dollars in thousands)	2003	2002	2001
Net interest income			
WCB	$ 28,384	$ 28,577	$ 27,039
NBG	25,642	26,853	24,732
BNB	15,019	14,048	8,184
FTB	8,207	8,175	6,041
Financial Services Group	--	--	--
Total segment net interest income	77,252	77,653	65,996
Parent and eliminations, net	(1,751)	(1,799)	(1,222)
Total net interest income	$ 75,501	$ 75,854	$ 64,774

Net income

WCB	$ 9,042	$ 10,565	$ 9,643
NBG	151	9,765	9,777
BNB	4,108	5,001	1,142
FTB	2,117	2,775	1,827
Financial Services Group	(115)	246	143
Total segment net income	15,303	28,352	22,532
Parent and eliminations, net	(1,056)	(1,896)	(1,319)
Total net income	$ 14,247	$ 26,456	$ 21,213
Assets			
WCB	$ 754,639	$ 674,755	$ 632,058
NBG	721,374	721,090	642,827
BNB	462,113	495,055	362,645
FTB	225,080	203,382	161,763
Financial Services Group	5,135	5,052	2,788
Total segment assets	2,168,341	2,099,334	1,802,081
Parent and eliminations, net	5,391	5,700	(7,785)
Total assets	$ 2,173,732	$ 2,105,034	$ 1,794,296

(18) Condensed Parent Company Only Financial Statements

The following are the condensed statements of condition of FII as of December 31, 2003 and 2002, and the condensed statements of income and cash flows for the years ended December 31, 2003, 2002 and 2001:

Condensed Statements of Condition

(Dollars in thousands)	2003	2002
Assets:		
Cash and due from subsidiaries	$ 13,698	$ 14,267
Securities available for sale, at fair value	1,436	1,268
Investment in subsidiaries	209,788	186,703
Other assets	5,098	5,099
Total assets	$230,020	$207,337
Liabilities and shareholders' equity		
Junior subordinated debentures	$ 16,702	$ 16,702
Short-term borrowings	--	500
Long-term borrowings	25,000	5,000
Other liabilities	5,215	6,841
Shareholders' equity	183,103	178,294

Total liabilities and shareholders' equity	$230,020	$207,337

Condensed Statements of Income

(Dollars in thousands)	2003	2002	2001
Dividends from subsidiaries	$ 6,058	$ 22,015	$ 16,643
Other income	10,542	8,542	7,577
Total income	16,600	30,557	24,220
Expenses	12,341	11,477	9,602
Income before income taxes and equity in undistributed earnings of subsidiaries	4,259	19,080	14,618
Income tax benefit	723	1,160	788
Income before effect of subsidiaries' earnings and dividends	4,982	20,240	15,406
Equity in undistributed earnings of subsidiaries	9,265	6,216	5,807
Net income	$ 14,247	$ 26,456	$ 21,213

Condensed Statements of Cash Flows

(Dollars in thousands)	2003	2002	2001
Cash flows from operating activities:			
Net income	$ 14,247	$ 26,456	$ 21,21
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	851	878	71
Equity in undistributed earnings of subsidiaries	(9,265)	(6,216)	(5,80
Deferred income tax expense (benefit)	70	(176)	(10
Gain on sale of securities	--	(161)	-
Decrease in accrued dividends receivable from subsidiaries	--	--	22,96
Increase in other assets	(588)	(4,953)	(1,13
(Decrease) increase in other liabilities	(442)	1,393	1,56
Net cash provided by			

operating activities	4,873	17,221	39,40
Cash flows from investing activities:			
Purchase of available for sale securities	--	(26)	-
Proceeds from sale of available for sale securities	--	256	-
Investment in Mercantile Adjustment Bureau, LLC	--	(2,400)	-
Equity investment in subsidiaries, net	(15,700)	--	(63,38
Purchase of premises and equipment, net	(645)	(274)	(1,10
Net cash used in investing activities	(16,345)	(2,444)	(64,49
Cash flows from financing activities:			
Proceeds from short-term borrowings	--	--	50
Proceeds from long-term borrowings	25,000	--	5,00
Repayment on long-term borrowings	(5,000)	--	-
Repayment of short-term borrowings	(500)	--	-
Proceeds from issuance of trust preferred securities	--	--	16,20
Purchase of preferred and common shares	(425)	(581)	(1
Issuance of preferred and common shares	447	463	2
Dividends paid	(8,619)	(7,578)	(6,55
Net cash provided by (used in) financing activities	10,903	(7,696)	15,16
Net (decrease) increase in cash and cash equivalents	(569)	7,081	(9,93
Cash and cash equivalents at the beginning of the year	14,267	7,186	17,11
Cash and cash equivalents at the end of the year	$ 13,698	$ 14,267	$ 7,18

INDEPENDENT AUDITORS' REPORT

The Board of Directors and Shareholders
Financial Institutions, Inc.:

We have audited the accompanying consolidated statements of financial condition of Financial Institutions, Inc. and subsidiaries as of December 31, 2003 and 2002, and the related consolidated statements of income, changes in shareholders' equity and comprehensive income, and cash flows for each of the years in the three-year period ended December 31, 2003. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted

in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Financial Institutions, Inc. and subsidiaries as of December 31, 2003 and 2002, and the results of their operations and their cash flows for each of the years in the three-year period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 1 and 6 to the consolidated financial statements, the Company changed its method of accounting for goodwill in 2002 upon adoption of Statement of Financial Accounting Standards No. 142, "Goodwill and Other Intangible Assets."

/s/ KPMG LLP

Buffalo, New York
February 6, 2004

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None.

Item 9A. Controls and Procedures

As of December 31, 2003 the Company, under the supervision of its Chief Executive Officer and Chief Financial Officer conducted an evaluation of the effectiveness of disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended). As part of a similar review, in early 2003, the Company identified two control issues at a subsidiary bank that if not corrected could impact the effectiveness of the Company's internal disclosure controls and procedures. The two areas of concern at the subsidiary bank were disclosure controls over the timing of problem loan identification and disclosure controls over lending to insiders under Regulation O. Since the identification of these issues, new procedures have been put in place to evaluate and assess the process of loan grading and problem loan identification at each subsidiary bank. The Company has also added credit administration and loan workout personnel at the holding company level to improve insider loan reporting and to facilitate earlier intervention with respect to problem loans. Based on their evaluation of the effectiveness of disclosure controls and procedures, and following the implementation of the above described actions, the Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective in ensuring that all material information required to be filed in the Company's periodic SEC reports is made known to them in a timely fashion. Except as described herein, there has been no change in the Company's internal control over financial reporting that occurred during the fourth quarter of the year ended December 31, 2003 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

PART III

Item 10. Directors and Executive Officers of the Registrant

Certain information required by this item is incorporated by reference from the Company's Proxy Statement for its 2004 Annual Meeting of Shareholders to be filed with the U.S. Securities and Exchange Commission.

The Company has adopted a Code of Ethics that applies to its principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions. The Code of Ethics is located on the Company's internet website at www.fiiwarsaw.com. In addition, the Company will provide a copy of the Code of Ethics to anyone, without charge, upon request addressed to Director of Human Resources at Financial Institutions, Inc., 220 Liberty Street, Warsaw, NY 14569. The Company intends to disclose any amendment to, or waiver from, a provision of its Code of Ethics that applies to the Company's principal executive officer, principal financial officer, principal accounting officer or controller, or persons performing similar functions, and that relates to any element of the Code of Ethics definition enumerated in Item 406 of Regulation S-K, by posting such information on the Company's website.

The following table sets forth current information about the executive officers of FII.

Name	Age	Starting In	Positions/Offices with FII and Subsidia
Peter G. Humphrey	49	1983	Chairman of the Board, President and Chief Executive O (since 1994). Chairman of the Boards of Wyoming County National Bank of Geneva, Bath National Bank and First Director of Burke Group, Inc. and The F. I. Group, Inc
Jon J. Cooper	51	1997	Senior Vice President of FII. President and Chief Exec Wyoming County Bank. Director of Wyoming County Bank.
Douglas L. McCabe	56	2001	Senior Vice President of FII. President and Chief Exec Bath National Bank since 1998. Director of Bath Nation
Randolph C. Brown	50	1991	Senior Vice President of FII. President and Chief Exec The National Bank of Geneva since 2003. From 1991 - 2 and CEO of First Tier Bank & Trust. Director of The Na Geneva.
Patrick C. Burke	43	2001	Senior Vice President of FII. President and Chief Exec The Burke Group, Inc. since 2001. Previous owner/partn Group. Director of The Burke Group, Inc. and The FI Gr
Gary M. Rougeau	54	1993	Senior Vice President of FII. President and Chief Exec First Tier Bank & Trust since 2003. From 1993 to 2003 Administrator for First Tier Bank. Director of First T
Ronald A. Miller	55	1996	Senior Vice President and Chief Financial Officer of F

			Secretary of FII.
Thomas D. Grover	56	2002	Senior Vice President and Chief Risk Officer of FII. F was the Executive Director for Canisius College Center Entrepreneurship. From 1999 - 2001 was Executive Vice Bank Small Business Services.
Matthew T. Murtha	49	2000	Senior Vice President and Director of Marketing of FII was Small Business Segment Manager at HSBC.

Item 11. Executive Compensation

Information regarding executive compensation on pages 10 through 14 of the Registrant's Proxy Statement for its 2004 Annual Meeting of Shareholders to be filed with the U.S. Securities and Exchange Commission is incorporated herein by reference thereto.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

Information regarding security ownership of certain beneficial owners of the Company's management on pages 6, 7 and 17 of the Registrant's Proxy Statement for its 2004 Annual Meeting of Shareholders to be filed with the U.S. Securities and Exchange Commission is incorporated herein by reference thereto.

The following table provides information as of December 31, 2003, regarding the Company's equity compensation plans.

Plan Category	Number of Securities to be Issued Upon Exercise of Oustanding Options, Warrants and Rights	Weighted Average Exercise Price of Oustanding Options, Warrants and Rights	Num Remai Futu Equity
Equity Compensation Plans Approved by Shareholders	432,276	17.89	
Equity Compensation Plans not Approved by Shareholders	--	--	

Item 13. Certain Relationships and Related Transactions

Information regarding certain relationships and related transactions on page 16 of the Registrant's Proxy Statement for its 2004 Annual Meeting of Shareholders to be filed with the U.S. Securities and Exchange Commission is incorporated herein by reference thereto.

Item 14. Principal Accountant Fees and Services

Information regarding principal accountant fees and services and pre-approval policies and procedures on pages 9 and 10 of the Registrant's Proxy Statement for its 2004 Annual Meeting of Shareholders to be filed with the U.S. Securities and Exchange Commission is incorporated herein by reference thereto.

PART IV

Item 15. Exhibits, Financial Statement Schedules and Reports on Form 8-K

(a) List of Documents Filed as Part of this Report

(1) Financial Statements.

The financial statements listed below and the Independent Auditors' Report are included in this Annual Report on Form 10-K:

Independent Auditors' Report

Consolidated Statements of Financial Condition as of December 31, 2003 and 2002

Consolidated Statements of Income for the years ended December 31, 2003, 2002 and 2001

Consolidated Statements of Changes in Shareholders' Equity and Comprehensive Income for the years ended December 31, 2003, 2002 and 2001

Consolidated Statements of Cash Flows the years ended December 31, 2003, 2002 and 2001

Notes to Consolidated Financial Statements

(2) Schedules.

All schedules are omitted since the required information is either not applicable, not required, or is contained in the respective financial statements or in the notes thereto.

(3) Exhibits.

The following is a list of all exhibits filed or incorporated by reference as part of this Registration Statement.

Exhibit No.	Description	Location
1.1	Term and Revolving Credit Loan Agreements between the Company and M&T Bank, dated December 15, 2003	Filed Herewith
3.1	Amended and Restated Certificate of Incorporation	Contained in Exhibit 3.1 o Registrant's Registration

		on Form S-1 dated June 25, (File No. 333-76865) (The "S-1 Registration Sta
3.2	Amended and Restated Bylaws dated May 23 ,2001	Contained in Exhibit 3.2 o for the year ended Decembe dated March 11, 2002
3.3	Amended and Restated Bylaws dated February 18, 2004	Filed Herewith
10.1	1999 Management Stock Incentive Plan	Contained in Exhibit 10.1 of the S-1 Registration St
10.2	1999 Directors Stock Incentive Plan	Contained in Exhibit 10.2 of the S-1 Registration St
11	Statement of Computation of Per Share Earnings	Contained in Note 14 of th Registrant's Consolidated Financial Statements Under Item 8 Filed Herewith
21	Subsidiaries of Financial Institutions, Inc.	Filed Herewith
23	Independent Accountants' Consent	Filed Herewith
24	Power of Attorney	Filed Herewith
31.1	Certification of Annual Report on Form 10-K pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 -CEO	Filed Herewith
31.2	Certification of Annual Report on Form 10-K pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 -CFO	Filed Herewith
32.1	Certification of Annual Report on Form 10-K pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 -CEO	Filed Herewith
32.2	Certification of Annual Report on Form 10-K pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 -CFO	Filed Herewith

(b) Reports on Form 8-K

The Company furnished a Current Report on Form 8-K dated October 16, 2003 relating to a press release to announce the Company's third quarter 2003 financial results.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FINANCIAL INSTITUTIONS, INC.

Date: March 12, 2004 By: /s/ Peter G. Humphrey

Peter G. Humphrey
President and Chief Executive Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, the following persons on behalf of the Registrant and in the capacities and on the date indicated have signed this report below.

Signatures	Title	Date
/s/ Peter G. Humphrey Peter G. Humphrey	President, Chief Executive Officer (Principal Executive Officer), Chairman of the Board and Director	March 12, 200
/s/ Ronald A. Miller Ronald A. Miller	Senior Vice President and Chief Financial Officer (Principal Accounting Officer)	March 12, 200
* John E. Benjamin	Director	March 12, 200
* Jon J. Cooper	Director and Senior Vice President	March 12, 200
* Barton P. Dambra	Director	March 12, 200
* Samuel M. Gullo	Director	March 12, 200
* Pamela Davis Heilman	Director	March 12, 200
 Joseph F. Hurley	Director	March 12, 200
* Susan R. Holliday	Director	March 12, 200
* W.J. Humphrey, Jr.	Director	March 12, 200
* James E. Stitt	Director	March 12, 200

*	Director	March 12, 200
John R. Tyler, Jr.		
*	Director	March 12, 200
James H. Wyckoff		

* The undersigned, acting pursuant to a power of attorney, has signed this Annual Report on Form 10-K for and on behalf of the persons indicated above as such persons' true and lawful attorney-in-fact and their names, places and stead, in the capacities and on the date indicated above.

/s/ Ronald A. Miller
Ronald A. Miller
Attorney-in-fact