

CHEMUNG FINANCIAL CORP
Form 10-K
March 13, 2008

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

FORM 10-K

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

For the fiscal year ended December 31, 2007

OR

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

For the transition period from _____ to _____

Commission File Number 0-13888

CHEMUNG FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

NEW YORK

16-123703-8

(I.R.S. Employer Identification No.)

State or other jurisdiction of
incorporation or organization

One Chemung Canal Plaza, P.O. Box 1522
Elmira, New York

14902

(Zip Code)

(Address of principal executive offices)

Registrant's telephone number, including area code: (607) 737-3711

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

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Common Stock, par value \$0.01 a share

(Title of class)

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.

YES NO

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

YES NO

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

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 amendment to this Form 10-K.

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

| | | | |
|-------------------------|-------------------------------------|---------------------------|--------------------------|
| Large accelerated filer | <input type="checkbox"/> | Non-accelerated filer | <input type="checkbox"/> |
| Accelerated filer | <input checked="" type="checkbox"/> | Smaller Reporting Company | <input type="checkbox"/> |

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES NO

Based upon the closing price of the registrant's Common Stock as of June 30, 2007, the aggregate market value of the voting stock held by non-affiliates of the registrant was \$58,409,949.

As of February 29, 2008 there were 3,523,388 shares of Common Stock, \$0.01 par value outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Proxy Statement for the Annual Meeting of Shareholders to be held on May 7, 2008 are incorporated by reference into Part III, Items 10, 11, 12, 13, and 14 of this Form 10-K.

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CHEMUNG FINANCIAL CORPORATION

ANNUAL REPORT ON FORM 10-K FOR THE FISCAL YEAR ENDED DECEMBER 31, 2007

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SIGNATURES

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Some of the information contained in this report concerning the markets and industry in which we operate is derived from publicly available information and from industry sources. Although we believe that this publicly available information and information provided by these industry sources are reliable, we have not independently verified the accuracy of any of this information.

PART I

ITEM 1. BUSINESS

General Development of Business

Chemung Financial Corporation (the "Corporation") was incorporated on January 2, 1985 under the laws of the State of New York. The Corporation was organized for the purpose of acquiring Chemung Canal Trust Company (the "Bank"). The Bank was established in 1833 under the name Chemung Canal Bank, and was subsequently granted a New York State bank charter in 1895. In 1902, the Bank was reorganized as a New York State trust company under the name Elmira Trust Company, and its name was changed to Chemung Canal Trust Company in 1903.

The Corporation has been a financial holding company since June 22, 2000. This provides the Corporation with the flexibility to offer an array of financial services, such as insurance products, mutual funds, and brokerage services. The Corporation believes that this allows it to better serve the needs of its clients as well as provide an additional source of fee based income. To that end, the Corporation established a financial services subsidiary, CFS Group, Inc., which commenced operations during September 2001. As such, the Corporation now operates as a financial holding company with two subsidiaries, Chemung Canal Trust Company, a full-service community bank with full trust powers, and CFS Group, Inc., a subsidiary offering non-banking financial services such as mutual funds, annuities, brokerage services and insurance.

The Securities and Exchange Commission (the "SEC") maintains a web site at www.sec.gov that contains reports, proxy and information statements, and other information regarding the Corporation. In addition, we maintain a corporate web site at www.chemungcanal.com. We make available free of charge through our web site our annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports pursuant to Section 13(a) or 15(d) of the Exchange Act and filed with the SEC. These items are available as soon as reasonably practicable after we electronically file or furnish such material with or to the SEC. The contents of our web site are not a part of this report. These materials are also available free of charge by written request to: Jane H. Adamy, Senior Vice President and Secretary, Chemung Canal Trust Company, One Chemung Canal Plaza, Elmira, NY 14901.

Description of Business

Business

The Bank is a New York chartered commercial bank which engages in full-service commercial and consumer banking and trust business. The Bank's services include accepting time, demand and savings deposits, including NOW accounts, regular savings accounts, insured money market accounts, investment certificates, fixed-rate certificates of deposit and club accounts. The Bank's services also include making secured and unsecured commercial and consumer loans, financing commercial transactions (either directly or participating with regional industrial development and community lending corporations), and making commercial, residential and home equity mortgage loans, revolving credit loans with overdraft checking protection, small business loans and student loans. Additional services include

renting safe deposit facilities and the provision of networked automated teller facilities.

Trust services provided by the Bank include services as executor and trustee under wills and agreements, and guardian, custodian, trustee and agent for pension, profit-sharing and other employee benefit trusts, as well as various investment, pension, estate planning and employee benefit administrative services.

CFS Group, Inc., a wholly owned subsidiary of the Corporation, commenced operations in September 2001 and offers an array of financial services including mutual funds, full and discount brokerage services, and annuity and other insurance products.

For additional information, which focuses on the results of operations of the Corporation and its subsidiaries, see Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7.

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There have been no material changes in the manner of doing business by the Corporation or its subsidiaries during the fiscal year ended December 31, 2007.

Market Area and Competition

Seven of the Bank's 18 full-service offices, including the main office, are located in Chemung County, New York. The Bank's other eleven full-service offices are located in the adjacent counties of Broome, Schuyler, Steuben, Tioga and Tompkins, with a Trust and Investment Center located in Herkimer County. All of the Bank's facilities are located in New York State. The Corporation defines its primary market areas as those areas within a 25-mile radius of its offices in Broome, Chemung, Herkimer, Steuben, Schuyler, Tioga and Tompkins counties, including the northern tier of Pennsylvania. The Bank's lending policy restricts substantially all lending efforts to these geographical regions.

Within these market areas, the Bank encounters intense competition in the lending and deposit gathering aspects of its business from commercial and thrift banking institutions, credit unions and other providers of financial services, such as brokerage firms, investment companies, insurance companies and Internet vendors. The Bank also competes with non-financial institutions, including retail stores and certain utilities that maintain their own credit programs, as well as governmental agencies that make available loans to certain borrowers. Unlike the Bank, many of these competitors are not subject to regulation as extensive as that of the Bank and, as a result, they may have a competitive advantage over the Bank in certain respects. This is particularly true of credit unions because their pricing structure is not encumbered by income taxes.

Competition for the Bank's Trust Department investment services comes primarily from brokerage firms and independent investment advisors. These firms devote much of their considerable resources toward gaining larger positions in these markets. The market value of the Bank's trust assets under administration totaled approximately \$1.9 billion at year-end 2007. The Trust and Investment Division is responsible for the largest component of non-interest revenue.

Supervision and Regulation

The Corporation, is regulated under the Bank Holding Company Act of 1956, as amended (the "BHC Act"), and is subject to the supervision of the Board of Governors of the Federal Reserve System (the "Federal Reserve Board"). As a bank holding company that has elected financial holding company status, the Corporation generally may engage in the activities of a bank holding company, which include banking, managing or controlling banks, performing certain servicing activities for subsidiaries, and engaging in other activities that the Federal Reserve Board has determined to be closely related to banking and a proper incident thereto. The Corporation may also engage in a broader range of activities that are determined by the Federal Reserve and the Secretary of the Treasury to be financial in nature or incidental to financial activities or activities that are determined by the Federal Reserve Board to be complementary to a financial activity and that do not pose a substantial risk to the safety and soundness of depository institutions or the financial system generally.

The Bank is chartered under the laws of New York State and is supervised by the New York State Banking Department ("NYSBD"). The Bank also is a member bank of the Federal Reserve System and, as such, the Federal Reserve Board serves as its primary federal regulator.

CFS Group, Inc. is subject to supervision by other regulatory authorities as determined by the activities in which it is engaged. Insurance activities are supervised by the New York State Insurance Department, and brokerage activities are subject to supervision by the SEC and the National Association of Securities Dealers, Inc. ("NASD").

The Corporation is subject to capital adequacy guidelines of the Federal Reserve Board. The guidelines apply on a consolidated basis and require bank holding companies to maintain a minimum ratio of Tier 1 capital to total average assets (or "leverage ratio") of 4%. For the most highly rated bank holding companies, the minimum ratio is 3%. The Federal Reserve Board capital adequacy guidelines also require bank holding companies to maintain a minimum ratio of Tier 1 capital to risk-weighted assets of 4% and a minimum ratio of qualifying total capital to risk-weighted assets of 8%. Any bank holding company whose capital does not meet the minimum capital adequacy guidelines is considered to be undercapitalized, and is

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required to submit an acceptable plan to the Federal Reserve Board for achieving capital adequacy. In addition, an undercapitalized company's ability to pay dividends to its shareholders and expand its lines of business through the acquisition of new banking or non-banking subsidiaries also could be restricted by the Federal Reserve Board. The Federal Reserve Board may set higher minimum capital requirements for bank holding companies whose circumstances warrant it, such as companies anticipating significant growth or facing unusual risks. As of December 31, 2007, the Corporation's leverage ratio was 10.14%, its ratio of Tier 1 capital to risk-weighted assets was 13.84% and its ratio of qualifying total capital to risk-weighted assets was 15.78%. The Federal Reserve Board has not advised the Corporation that it is subject to any special capital requirements.

The Bank is subject to leverage and risk-based capital requirements and minimum capital guidelines of the Federal Reserve Board that are similar to those applicable to the Corporation. As of December 31, 2007, the Bank was in compliance with all minimum capital requirements. The Bank's leverage ratio was 9.70%, its ratio of Tier 1 capital to risk-weighted assets was 13.26%, and its ratio of qualifying total capital to risk-weighted assets was 15.19%.

The Bank also is subject to substantial regulatory restrictions on its ability to pay dividends to the Corporation. Under Federal Reserve Board and NYSBD regulations, the Bank may not pay a dividend without prior approval of the Federal Reserve and the NYSBD if the total amount of all dividends declared during such calendar year, including the proposed dividend, exceeds the sum of its retained net income to date during the calendar year and its retained net income over the preceding two calendar years. As of December 31, 2007, approximately \$5.9 million was available for the payment of dividends by the Bank to the Corporation without prior approval, after giving effect to the payment of dividends in the fourth quarter of 2007. The Bank's ability to pay dividends also is subject to the Bank being in compliance with regulatory capital requirements. The Bank is currently in compliance with these requirements.

The deposits of the Bank are insured up to regulatory limits by the Federal Deposit Insurance Corporation ("FDIC"). The Federal Deposit Insurance Reform Act of 2005, which was signed into law on February 8, 2006, gave the FDIC increased flexibility in assessing premiums on banks and savings associations, including the Bank, to pay for deposit insurance and in managing its deposit insurance reserves. The FDIC has adopted regulations to implement its new authority. Under these regulations, all insured depository institutions are placed into one of four risk categories. According to FDIC estimates, approximately 95% of all insured institutions, including the Bank, are in Risk Category I, the most favorable category. Within this category, all insured institutions pay a base rate assessment of \$0.02 to \$0.04 per \$100 of assessable deposits (which rate may be adjusted annually by the FDIC by up to \$0.03 per \$1000 of assessable deposits without public comment) based on the risk of loss to the Depository Insurance Fund ("DIF") posed by the particular institution. Assessment rates for Category I institutions are currently 5-7 basis points. For institutions such as the Bank, which do not have a long-term public debt rating, the individual risk assessment is based on its supervisory ratings and certain financial ratios and other measurements of its financial condition. For institutions that have a long-term public debt rating, the individual risk assessment is based on its supervisory ratings and its debt rating. The new law became effective on January 1, 2007, and the first premiums, payable quarterly after the end of each quarter, were payable by June 30, 2007. The reform legislation also provided a credit to all insured depository institutions, based on the amount of their insured deposits at year-end 1996, that may be used as an offset to the premiums that are assessed. The Bank received a credit of approximately \$598 thousand, which entirely offset its 2007 deposit insurance assessment. A credit balance of \$366 thousand remained at year-end 2007, which will be used to partially offset the Bank's 2008 deposit insurance assessment.

The Federal Deposit Insurance Act provides for additional assessments to be imposed on insured depository institutions to pay for the cost of Financing Corporation ("FICO") funding. The FICO assessments are adjusted quarterly to reflect changes in the assessment bases of the FDIC insurance funds and do not vary depending upon a depository institution's capitalization or supervisory evaluation. During 2007, FDIC assessments for purposes of funding FICO bond obligations ranged from an annualized \$0.0122 per \$100 of deposits for the first quarter of 2007 to \$0.0114 per \$100 of deposits for the fourth quarter of 2007. The Bank paid \$69 thousand of FICO assessments in 2007. For the first quarter of 2008, the FICO assessment rate is \$0.0114 per \$100 of deposits.

Transactions between the Bank, and either the Corporation or CFS Group, Inc., are

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governed by sections 23A and 23B of the Federal Reserve Act and Federal Reserve Board regulations thereunder. Generally, sections 23A and 23B are intended to protect insured depository institutions from suffering losses arising from transactions with non-insured affiliates, by placing quantitative and qualitative limitations on covered transactions between a bank and any one affiliate as well as all affiliates of the bank in the aggregate, and requiring that such transactions be on terms that are consistent with safe and sound banking practices.

In 2007, the Federal Reserve Board and SEC issued a final joint rulemaking to clarify that traditional banking activities involving some elements of securities brokerage activities, such as most trust and fiduciary activities, may continue to be performed by banks rather than being "pushed out" to affiliates supervised by the SEC.

Under the Gramm-Leach-Bliley Act ("GLB Act"), all financial institutions, including the Corporation, the Bank and CFS Group, Inc. are required to establish policies and procedures to restrict the sharing of nonpublic customer data with nonaffiliated parties at the customer's request and to protect customer data from unauthorized access. In addition, the Fair and Accurate Credit Transactions Act of 2003 ("FACT Act") includes many provisions concerning national credit reporting standards and permits customers, including customers of the Bank, to opt out of information-sharing for marketing purposes among affiliated companies. The FACT Act also requires banks and other financial institutions to notify their customers if they report negative information about them to a credit bureau or if they are granted credit on terms less favorable than those generally available. The Federal Reserve Board and the Federal Trade Commission ("FTC") have extensive rule making authority under the FACT Act, and the Corporation and the Bank are subject to the rules that have been promulgated by the Federal Reserve Board and FTC. The Corporation has developed policies and procedures for itself and its subsidiaries to maintain compliance and believes it is in compliance with all privacy, information sharing and notification provisions of the GLB Act and the FACT Act.

Periodic disclosures by companies in various industries of the loss or theft of computer-based nonpublic customer information have led several members of Congress to call for the adoption of national standards for the safeguarding of such information and the disclosure of security breaches. Several committees of both houses of Congress have conducted hearings on data security and related issues, and have proposed legislation regarding these issues.

Under Title III of the USA PATRIOT Act, also known as the International Money Laundering Abatement and Anti-Terrorism Financing Act of 2001, all financial institutions are required in general to identify their customers, adopt formal and comprehensive anti-money laundering programs, scrutinize or prohibit altogether certain transactions of special concern, and be prepared to respond to inquiries from U.S. law enforcement agencies concerning their customers and their transactions. Additional information-sharing among financial institution, regulators, and law enforcement authorities is encouraged by the presence of an exemption from the privacy provisions of the GLB Act for financial institutions that comply with this provision and the authorization of the Secretary of the Treasury to adopt rules to further encourage cooperation and information-sharing. The effectiveness of a financial institution in combating money laundering activities is a factor to be considered in any application submitted by the financial institution under the Bank Merger Act, which applies to the Bank, or the BHC Act, which applies to the Corporation.

Failure of a financial institution to maintain and implement adequate programs to combat money laundering and terrorist financing, or to comply with all of the relevant laws or regulations, could have serious legal, financial and reputational consequences for the institution. In that regard, the Bank was notified by the Federal Reserve Bank of New York of deficiencies in its Bank Secrecy Act ("BSA") and Anti Money Laundering ("AML") compliance program. Subsequent to year-end 2007, the Bank has commenced corrective action. Among the primary areas the Bank is addressing are customer due diligence, transaction monitoring, employee training, and internal testing of compliance.

The Sarbanes-Oxley Act of 2002 implemented a broad range of measures to increase corporate responsibility, enhance penalties for accounting and auditing improprieties at publicly traded companies, and protect investors by improving the accuracy and reliability of corporate disclosures for companies that have securities registered under the Exchange Act, including publicly-held financial holding companies such as the Corporation. It includes very specific additional

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disclosure requirements and corporate governance rules, and the SEC and securities exchanges have adopted extensive additional disclosures, corporate governance and other related rules pursuant to its mandate. The Act represents significant federal involvement in matters traditionally left to state regulatory systems, such as the regulation of the accounting profession, and to state corporate law, such as the relationship between a board of directors and management and between a board of directors and its committees. In addition, the federal banking regulators have adopted generally similar requirements concerning the certification of financial statements by bank officials.

Home mortgage lenders, including banks, are required under the Home Mortgage Disclosure Act to make available to the public expanded information regarding the pricing of home mortgage loans, including the "rate spread" between the interest rate on loans and certain Treasury securities and other benchmarks. The availability of this information has led to increased scrutiny of higher-priced loans at all financial institutions to detect illegal discriminatory practices and to the initiation of a limited number of investigations by federal banking agencies and the U.S. Department of Justice. The Corporation has no information that it or its affiliates are the subject of any investigation.

During 2007, the Federal Reserve, OCC and other federal financial regulatory agencies issued final guidance on subprime mortgage lending to address issues relating to certain subprime mortgages, especially adjustable-rate mortgage (ARM) products that can cause payment shock. The subprime guidance described the prudent safety and soundness and consumer protection standard that the regulators expect banks and financial institutions, such as the Corporation and the Bank, to follow to ensure borrowers obtain loans they can afford to repay.

In December 2006, the Federal Reserve, OCC and other federal financial regulatory agencies issued similar final guidance on sound risk management practices for concentrations in commercial real estate (CRE) lending. The CRE guidance provided supervisory criteria, including numerical indicators to direct examiners in identifying institutions with potentially significant CRE loan concentrations that may warrant greater supervisory scrutiny. The CRE criteria do not constitute limits on CRE lending, but the CRE guidance does provide certain additional expectations, such as enhanced risk management practices and levels of capital, for banks with concentrations in CRE lending.

Employees

As of December 31, 2007, the Corporation and its subsidiaries employed 280 persons on a full-time equivalent basis. None of the Corporation's employees are covered by collective bargaining agreements, and the Corporation believes that its relationship with its employees is good.

Financial Information About Foreign and Domestic Operations and Export Sales

Neither the Corporation nor its subsidiaries relies on foreign sources of funds or income.

Statistical Disclosure by Bank Holding Companies

The following disclosures present certain summarized statistical data covering the Corporation and its subsidiaries. See also Management's Discussion and Analysis of Financial Condition and Results of Operations in Part II, Item 7, of this report for other required statistical data.

Investment Portfolio

The following table sets forth the carrying amount of investment securities at the dates indicated (in thousands of dollars):

| | December 31, | | |
|-------------------------------------------------------------------------|------------------|------------------|------------------|
| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
| Obligations of U.S. Government and U.S Government sponsored enterprises | \$ 81,943 | \$ 80,134 | \$104,699 |
| Mortgage-backed securities | 56,285 | 69,206 | 87,104 |
| Obligations of states and political subdivisions | 17,963 | 23,950 | 27,801 |
| Corporate bonds and notes | 4,442 | 9,275 | 13,026 |
| Corporate stocks | <u>9,168</u> | <u>9,131</u> | <u>8,935</u> |
| Total | <u>\$169,801</u> | <u>\$191,696</u> | <u>\$241,565</u> |

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Included in the above table are \$165,321, \$184,830 and \$232,979 (in thousands of dollars) of securities available for sale at December 31, 2007, 2006 and 2005, respectively. Also included in the above table are \$4,480, \$6,866 and \$8,586 (in thousands of dollars) of securities held to maturity at December 31, 2007, 2006 and 2005, respectively.

The following table sets forth the carrying amounts and maturities of debt securities at December 31, 2007 and the weighted average yields of such securities (all yields are calculated on the basis of the amortized cost and weighted for the scheduled maturity of each security, except mortgage-backed securities which are based on the average life at the projected prepayment speed of each security). Federal tax equivalent adjustments have not been made in calculating yields on municipal obligations (in thousands of dollars):

Maturing

After One, But Within Five

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| | Within One Year | | Years | |
|-------------------------------------------------------------------------|------------------|--------------|------------------|--------------|
| | <u>Amount</u> | <u>Yield</u> | <u>Amount</u> | <u>Yield</u> |
| Obligations of U.S. Government and U.S Government sponsored enterprises | \$ 26,877 | 4.88% | \$ 45,098 | 4.23% |
| Mortgage-backed securities | 1,767 | 4.30% | 46,930 | 4.12% |
| Obligations of states and political subdivisions | 4,147 | 4.09% | 7,208 | 3.73% |
| Corporate bonds and notes | <u>2,083</u> | <u>9.22%</u> | = | = |
| Total | <u>\$ 34,874</u> | <u>4.98%</u> | <u>\$ 99,236</u> | <u>4.14%</u> |

Maturing

| | After Five, But Within Ten Years | | After Ten Years | |
|-------------------------------------------------------------------------|----------------------------------|--------------|-----------------|--------------|
| | <u>Amount</u> | <u>Yield</u> | <u>Amount</u> | <u>Yield</u> |
| Obligations of U.S. Government and U.S Government sponsored enterprises | \$ 9,968 | 4.37% | \$ - | - |
| Mortgage-backed securities | 7,345 | 3.97% | 243 | 7.02% |
| Obligations of states and political subdivisions | 6,153 | 3.78% | 455 | 5.41% |
| Corporate bonds and notes | <u>2,359</u> | <u>5.17%</u> | = | = |
| Total | <u>\$ 25,825</u> | <u>4.19%</u> | <u>\$ 698</u> | <u>5.96%</u> |

Loan Portfolio

The following table shows the Corporation's loan distribution at the end of each of the last five years, excluding net deferred origination fees and costs, and unearned income (in thousands of dollars):

| | December 31, | | | | |
|----------------------------------------|--------------|-------------|-------------|-------------|-------------|
| | <u>2007</u> | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> |
| Commercial, financial and agricultural | \$131,219 | \$138,338 | \$140,781 | \$118,498 | \$131,583 |

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| | | | | | |
|-------------------------|------------------|------------------|------------------|------------------|------------------|
| Commercial mortgages | 70,632 | 54,666 | 41,571 | 44,654 | 43,918 |
| Residential mortgages | 159,087 | 133,286 | 97,199 | 88,042 | 87,503 |
| Indirect consumer loans | 89,609 | 65,853 | 59,676 | 55,858 | 52,302 |
| Consumer loans | <u>86,572</u> | <u>83,733</u> | <u>78,522</u> | <u>74,153</u> | <u>75,229</u> |
| Total | <u>\$537,119</u> | <u>\$475,876</u> | <u>\$417,749</u> | <u>\$381,205</u> | <u>\$390,535</u> |

The following table shows the maturity of loans (excluding residential mortgages, indirect consumer, and consumer loans) outstanding as of December 31, 2007. Also provided are the amounts due after one year, classified according to the sensitivity to changes in interest rates (in thousands of dollars):

| | <u>Within One Year</u> | <u>After One But Within Five Years</u> | <u>After Five Years</u> | <u>Total</u> |
|----------------------------------------|----------------------------|------------------------------------------------|-----------------------------|------------------|
| Commercial, financial and agricultural | <u>\$27,004</u> | <u>\$ 57,137</u> | <u>\$117,710</u> | <u>\$201,851</u> |
| Loans maturing after one year with: | | | | |
| Fixed interest rates | N/A | \$ 23,834 | \$ 19,412 | \$ 43,246 |
| Variable interest rates | N/A | <u>33,303</u> | <u>98,298</u> | <u>131,601</u> |
| Total | N/A | <u>\$ 57,137</u> | <u>\$117,710</u> | <u>\$174,847</u> |

Loan Concentrations

At December 31, 2007, the Corporation had no loan concentrations to borrowers engaged in the same or similar industries that exceed 10% of total loans.

Allocation of the Allowance for Loan Losses

The allocated portions of the allowance reflect management's estimates of specific known risk elements in the respective portfolios. Beginning in 2006 and continuing during 2007, management refined the methodology followed in evaluating the allowance for loan losses to include a more detailed analysis of historical loss factors for pools of similarly graded loans, as well as implementing a specific collateral review of relationships graded special mention, substandard or doubtful

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with outstanding balances of \$1.0 million or greater. Among the factors considered in allocating portions of the allowance by loan type are the current levels of past due, non-accrual and impaired loans, as well as historical loss experience and the evaluation of collateral. In addition, management has more formally documented factors considered in determining the appropriate level of unallocated allowance, including current economic conditions, forecasted trends in the credit quality cycle, loan growth, entry into new markets, and industry and peer group trends. In 2007, these amounts, which had previously been shown as unallocated, have been included in the allocated portion of the loan categories to which they relate. The following table summarizes the Corporation's allocation of the loan loss allowance for each year in the five-year period ended December 31, 2007:

Amount of loan loss allowance (in thousands) and Percent of Loans
by Category to Total Loans (%)

| Balance at end of period applicable to: | <u>2007</u> | <u>%</u> | <u>2006</u> | <u>%</u> | <u>2005</u> | <u>%</u> | <u>2004</u> | <u>%</u> | <u>2003</u> | <u>%</u> |
|-----------------------------------------------|----------------|--------------|----------------|--------------|----------------|--------------|----------------|--------------|----------------|--------------|
| Commercial, financial and agricultural | \$3,955 | 24.3 | \$4,122 | 29.0 | \$2,990 | 33.7 | \$1,883 | 31.7 | \$3,198 | 33.7 |
| Commercial mortgages | 3,113 | 13.1 | 2,473 | 11.4 | 3,530 | 10.0 | 5,206 | 11.6 | 4,579 | 11.2 |
| Residential mortgages | 479 | 29.6 | 214 | 28.0 | 342 | 23.3 | 321 | 22.9 | 322 | 22.4 |
| Consumer loans | <u>906</u> | <u>33.0</u> | <u>574</u> | <u>31.6</u> | <u>846</u> | <u>33.0</u> | <u>908</u> | <u>33.8</u> | <u>951</u> | <u>32.7</u> |
| | 8,453 | 100.0 | 7,383 | 100.0 | 7,708 | 100.0 | 8,318 | 100.0 | 9,050 | 100.0 |
| Unallocated | - | <u>N/A</u> | <u>600</u> | <u>N/A</u> | <u>2,070</u> | <u>N/A</u> | <u>1,665</u> | <u>N/A</u> | <u>798</u> | <u>N/A</u> |
| Total | <u>\$8,453</u> | <u>100.0</u> | <u>\$7,983</u> | <u>100.0</u> | <u>\$9,778</u> | <u>100.0</u> | <u>\$9,983</u> | <u>100.0</u> | <u>\$9,848</u> | <u>100.0</u> |

The allocation of the allowance to each category does not restrict the use of the allowance to absorb losses in any category.

Deposits

The average daily amounts of deposits and rates paid on such deposits is summarized for the periods indicated in the following table (in thousands of dollars):

Year Ended December 31,

2007

2006

2005

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| | <u>Amount</u> | <u>Rate</u> | <u>Amount</u> | <u>Rate</u> | <u>Amount</u> | <u>Rate</u> |
|-------------------------------------------|------------------|-------------|------------------|-------------|------------------|-------------|
| Non-interest-bearing demand deposits | \$146,379 | - % | \$139,626 | - % | \$132,618 | - % |
| Interest-bearing demand deposits | 37,551 | 0.36 | 38,249 | 0.46 | 43,301 | 0.40 |
| Savings and insured money market deposits | 164,288 | 1.78 | 165,258 | 1.57 | 166,814 | 0.99 |
| Time deposits | <u>244,343</u> | 4.44 | <u>225,165</u> | 4.12 | <u>187,316</u> | 2.99 |
| | <u>\$592,561</u> | | <u>\$568,298</u> | | <u>\$530,049</u> | |

Scheduled maturities of time deposits at December 31, 2007 are summarized as follows (in thousands of dollars):

| | |
|------------|-------------------|
| 2008 | \$ 165,443 |
| 2009 | 37,610 |
| 2010 | 11,612 |
| 2011 | 6,021 |
| 2012 | 6,320 |
| Thereafter | <u>165</u> |
| | <u>\$ 227,171</u> |

Maturities of time deposits in denominations of \$100,000 or more outstanding at December 31, 2007 are summarized as follows (in thousands of dollars):

| | |
|--------------------------|------------------|
| 3 months or less | \$ 22,479 |
| Over 3 through 6 months | 6,073 |
| Over 6 through 12 months | 9,725 |
| Over 12 months | <u>25,574</u> |
| | <u>\$ 63,851</u> |

Return on Equity and Assets

The following table shows consolidated operating and capital ratios of the Corporation for each of the last three years:

| <u>Year Ended December 31,</u> | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|--------------------------------|-------------|-------------|-------------|
| Return on average assets | 0.95% | 0.91% | 0.92% |

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| | | | |
|------------------------------------------|--------|--------|--------|
| Return on average equity | 8.58% | 8.11% | 8.08% |
| Dividend payout ratio | 47.02% | 51.94% | 52.68% |
| Average equity to average assets ratio | 11.03% | 11.25% | 11.40% |
| Year-end equity to year-end assets ratio | 11.17% | 11.08% | 11.31% |

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Short-Term Borrowings

For each of the three years in the period ended December 31, 2007, the average outstanding balance of short-term borrowings did not exceed 30% of shareholders' equity.

Securities Sold Under Agreements to Repurchase and Federal Home Loan Bank ("FHLB") Advances

Information regarding securities sold under agreements to repurchase and FHLB advances is included in notes 8 and 9 to the consolidated financial statements appearing elsewhere in this report.

ITEM 1A. RISK FACTORS

The Corporation's business is subject to many risks and uncertainties. Although the Corporation seeks ways to manage these risks and develop programs to control those that management can, the Corporation ultimately cannot predict the extent to which these risks and uncertainties could affect results. Actual results may differ materially from management's expectations. Some of the significant risks and uncertainties are discussed below.

Changes in economic conditions or interest rates.

The results of operations for financial institutions, including the Corporation, may be materially and adversely affected by changes in prevailing local and national economic conditions, including declines in real estate market values, rapid increases or decreases in interest rates and changes in the monetary and fiscal policies of the federal government. The Corporation's profitability is heavily influenced by the spread between the interest rates earned on investments and loans and the interest rates paid on deposits and other interest-bearing liabilities. Substantially all of the Bank's loans are to businesses and individuals in the southern tier of New York and northern tier of Pennsylvania, and any decline in the economy of this area could adversely affect results. Like most financial institutions, the Corporation's net interest spread and margin will be affected by general economic conditions and other factors that influence market interest rates and the ability to respond to changes in such rates. At any given time, assets and liabilities may be such that they are affected differently by a given change in interest rates. For additional information, see Part II, Item 7, "Interest Rate Risk."

Credit Risk. A significant source of risk for the Bank 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 loan agreements. Loans originated by the Bank can be either secured or 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 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 industry recognized standards may create the impression that a loan is adequately collateralized when in fact it is not. The Bank 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 Bank's credit portfolio. Such policies and procedures, however, may not prevent unexpected losses that could have a material adverse effect on the Bank's business, financial condition, results of operations or liquidity. For further information regarding asset quality, see Part II, Item 7, "Management of Credit Risk-Loan Portfolio" and "Asset Quality."

Litigation risk.

Neither the Corporation nor its subsidiaries are a party to any material pending legal proceedings. If in the future any legal action is determined adversely to the Corporation, or if any legal action resulted in the Corporation paying a substantial settlement, then such adverse determination or settlement may have a material adverse effect on the Corporation's financial condition.

Difficulties in managing our growth.

As part of the Corporation's strategy for continued growth, we may open additional branches. New branches do not initially

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contribute to operating profits due to the impact of overhead expenses and the start-up phase of generating loans and deposits. To the extent that additional branches are opened, the Corporation may experience the effects of higher operating expenses relative to operating income from the new operations, which may have an adverse affect on the Corporation's levels of net income, return on average equity and return on average assets.

In addition, the Corporation may acquire banks and related businesses that it believes provide a strategic fit with its business. To the extent that the Corporation grows through acquisitions, it cannot provide assurance that such strategic decisions will be initially accretive to earnings.

Competition.

The Corporation faces substantial competition in all phases of its operations from a variety of different competitors. Future growth and success will depend on the ability to compete effectively in this highly competitive environment. The Corporation competes for deposits, loans and other financial services with a variety of banks, thrifts, credit unions and other financial institutions as well as other entities which provide financial services. Some of the financial institutions and financial services organizations with which we compete are not subject to the same degree of regulation as the Corporation. Many competitors have been in business for many years, have established customer bases, are larger, and have substantially higher lending limits. The financial services industry is also likely to become more competitive as further

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technological advances enable more companies to provide financial services. These technological advances may diminish the importance of depository institutions and other financial intermediaries in the transfer of funds between parties. For further information, see Part II, Item 7, "Competition."

Government regulation.

The financial services industry is heavily regulated under both federal and state law. These regulations are primarily intended to protect customers, not creditors or shareholders. As a financial holding company, the Corporation is also subject to extensive regulation by the Federal Reserve, in addition to other regulatory organizations. The ability to establish new facilities or make acquisitions is conditioned upon the receipt of the required regulatory approvals from these organizations. Regulations affecting banks and financial services companies undergo continuous change, and the Corporation cannot predict the ultimate effect of such changes, which could have a material adverse effect on profitability or financial condition. For further information, see Part I, Item 1, "Supervision and Regulation."

Technological change and breach of information security.

The banking industry is undergoing rapid technological changes with frequent introductions of new technology-driven products and services. The Corporation's future success will depend, in part, on the ability to address the needs of customers by using technology to provide products and services that will satisfy customer demands for convenience as well as to create additional efficiencies in operations. Many competitors have substantially greater resources to invest in technological improvements. There can be no assurance that the Corporation will be able to effectively implement new technology-driven products and services or be successful in marketing such products and services to customers.

Despite instituted safeguards, the Corporation cannot be certain that all of its systems are entirely free from vulnerability to attack or other technological difficulties or failures. The Corporation 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 Corporation could be exposed to claims from customers. Any of these results could have a material adverse effect on the Corporation's business, financial condition, results of operations or liquidity.

ITEM 1B. UNRESOLVED STAFF COMMENTS

None.

ITEM 2. PROPERTIES

The Corporation and the Bank currently conduct all their business activities from the Bank's main office in Elmira, NY, 17 full-service locations and one representative office situated in a seven-county area, owned office space adjacent to the Bank's main office in Elmira, NY, and twelve off-site automated teller facilities (ATMs), seven of which are located on leased property. The main office is a six-story structure located at One Chemung Canal Plaza, Elmira, New York, in the downtown

business district. The main office consists of approximately 59,342 square feet of space, of which 745 square feet is occupied by the Corporation's subsidiary CFS Group, with the remaining 58,597 square feet entirely occupied by the Bank. The combined square footage of the 17 branch banking facilities totals approximately 75,232 square feet. The office building adjacent to the main office was acquired during 1995 and consists of approximately 33,186 square feet of which 30,766 square feet are occupied by operating departments of the Bank and 2,420 square feet are leased. The leased automated teller facility spaces total approximately 384 square feet.

The Bank operates three of its facilities (Bath, Community Corners & Binghamton Offices) and seven automated teller facilities (two Byrne Dairy Food Stores, Convenient Food Mart, Elmira College, Elmira/Corning Regional Airport, General Revenue Corp., and Wal-Mart Store) under lease arrangements. The rest of its offices, including the main office and the adjacent office building, are owned by the bank. All properties owned or leased by the Bank are considered to be in good condition.

The Corporation holds no real estate in its own name.

ITEM 3. LEGAL PROCEEDINGS

Neither the Corporation nor its subsidiaries are a party to any material pending legal proceedings.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

There were no matters submitted to a vote of shareholders during the fourth quarter of 2007.

PART II

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

The Corporation's stock is traded in the over-the-counter market under the symbol CHMG.OB.

Below are the quarterly market price ranges for the Corporation's stock for the past two years, based upon actual transactions as reported by securities brokerage firms which maintain a market or conduct trades in the Corporation's stock and other transactions known by the Corporation's management.

Market Prices During Past Two Years (dollars)

| | <u>2007</u> | <u>2006</u> |
|-------------|---------------|---------------|
| 1st Quarter | 30.00 - 33.00 | 29.50 - 30.90 |
| 2nd Quarter | 29.05 - 32.10 | 29.05 - 31.75 |
| 3rd Quarter | 27.55 - 31.00 | 29.40 - 32.00 |
| 4th Quarter | 25.49 - 30.00 | 31.00 - 33.75 |

Below are the dividends paid quarterly by the Corporation for each share of the Corporation's common stock over the last three years:

Dividends Paid Per Share During Past Three Years

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|---------|---------------|---------------|---------------|
| January | \$0.24 | \$0.24 | \$0.24 |
| April | 0.24 | 0.24 | 0.24 |
| July | 0.24 | 0.24 | 0.24 |
| October | <u>0.24</u> | <u>0.24</u> | <u>0.24</u> |
| | <u>\$0.96</u> | <u>\$0.96</u> | <u>\$0.96</u> |

The Bank is also subject to legal limitations on the amount of dividends that can be paid to the Corporation without prior regulatory approval. Dividends are limited to retained net profits, as defined by regulations, for the current year and the two preceding years. At December 31, 2007, approximately \$5.9 million was available for the declaration of dividends from the Bank to the Corporation.

As of February 29, 2008 there were 574 registered holders of record of the Corporation's stock.

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The table below sets forth the information with respect to purchases made by the Corporation of our common stock during the quarter ended December 31, 2007:

| Period | Total number of shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
|------------------------|----------------------------------|------------------------------|----------------------------------------------------------------------------------|--------------------------------------------------------------------------------|
| 10/1/07-10/31/07 | 2,200 | \$27.99 | 2,200 | 129,187 |
| 11/1/07-11/30/07 | 1,237 | \$27.27 | 1,237 | 127,950 |
| 12/1/07-12/31/07 | <u>75</u> | <u>\$27.25</u> | <u>75</u> | <u>127,875</u> |
| Quarter ended 12/31/07 | <u>3,512</u> | <u>\$27.72</u> | <u>3,512</u> | <u>127,875</u> |

(1) On November 16, 2006, the Corporation announced that its Board of Directors had authorized the repurchase of up to 180,000 shares, or approximately 5% of the Corporation's then outstanding common stock over a two-year period, expiring November 15, 2008. Purchases will be made from time to time on the open-market or in private negotiated transactions, and will be at the discretion of management. Of the above 3,512 total shares repurchased by the Corporation, 1,700 shares were repurchased through open-market

transactions and the remaining 1,812 shares were repurchased in direct transactions.

STOCK PERFORMANCE GRAPH

The following graph compares the yearly change in the cumulative total shareholder return on the Corporation's common stock against the cumulative total return of the NASDAQ Stock Market (U.S. Companies), NASDAQ Bank Stocks Index and SNL \$500M - \$1B Bank Index for the period of five years commencing December 31, 2002.

[stockperfgraph.gif](#)

| <u>Index as of December 31,</u> | <u>2002</u> | <u>2003</u> | <u>2004</u> | <u>2005</u> | <u>2006</u> | <u>2007</u> |
|---------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|
| Chemung Financial Corporation | 100.00 | 140.81 | 128.74 | 125.21 | 133.95 | 121.15 |
| NASDAQ Composite | 100.00 | 150.01 | 162.89 | 165.13 | 180.85 | 198.60 |
| NASDAQ Bank | 100.00 | 129.93 | 144.21 | 137.97 | 153.15 | 119.35 |
| SNL \$500M - \$1B Bank Index | 100.00 | 144.19 | 163.41 | 170.41 | 193.81 | 155.31 |

The cumulative total return includes (1) dividends paid and (2) changes in the share price of the Corporation's common stock and assumes that all dividends were reinvested. The above graph assumes that the value of the investment in Chemung Financial Corporation and each index was \$100 on December 31, 2002.

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The Total Returns Index for NASDAQ Stock Market (U.S. Companies) and Bank Stocks indices were obtained from SNL Financial LC, Charlottesville, VA.

ITEM 6. SELECTED FINANCIAL DATA

The following table presents selected financial data as of and for the years ended December 31, 2003, 2004, 2005, 2006 and 2007. The selected financial data is derived from our audited consolidated financial statements appearing elsewhere in this report.

The selected financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements and related notes thereto appearing elsewhere in this report.

SUMMARIZED BALANCE SHEET DATA AT DECEMBER 31

| | <u>2007</u> | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> |
|-------------------------|-------------|-------------|-------------|-------------|-------------|
| , (in thousands) | | | | | |
| Total assets | \$788,874 | \$739,050 | \$718,039 | \$722,544 | \$747,209 |

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| | | | | | |
|------------------------------------------------------------|---------|---------|---------|---------|---------|
| Loans, net of deferred fees and costs, and unearned income | 539,522 | 477,664 | 418,685 | 381,508 | 390,353 |
| Investment Securities | 169,801 | 191,696 | 241,566 | 255,525 | 290,537 |
| Federal Home Loan Bank and Federal Reserve Bank stock | 5,902 | 3,605 | 5,356 | 5,944 | 5,468 |
| Deposits | 572,600 | 585,092 | 524,937 | 519,560 | 551,051 |
| Securities sold under agreements to repurchase | 31,212 | 35,024 | 60,856 | 88,505 | 79,035 |
| Federal Home Loan Bank Advances | 82,400 | 27,900 | 40,800 | 25,000 | 25,000 |
| Shareholders' equity | 88,115 | 82,298 | 81,178 | 82,196 | 79,993 |

| SUMMARIZED EARNINGS DATA FOR THE YEARS ENDED DECEMBER 31, (in thousands) | <u>2007</u> | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> |
|-----------------------------------------------------------------------------|-------------|-------------|-------------|-------------|-------------|
| Net interest income | \$25,936 | \$24,546 | \$24,737 | \$25,257 | \$25,864 |
| Provision for loan losses | 1,255 | 125 | 1,300 | 1,500 | 4,700 |
| Net interest income after provision for loan losses | 24,681 | 24,421 | 23,437 | 23,757 | 21,164 |
| Other operating income: | | | | | |
| Trust and investment services income | 6,345 | 4,901 | 5,095 | 4,725 | 4,501 |
| Securities gains, net | 10 | 27 | 6 | 602 | 1,185 |
| Net gains on sales of loans held for sale | 98 | 103 | 107 | 983 | 245 |
| Other income | 10,176 | 9,281 | 7,806 | 7,958 | 7,415 |
| Total other operating income | 16,629 | 14,312 | 13,014 | 14,268 | 13,346 |
| Other operating expenses | 30,521 | 29,523 | 27,315 | 25,481 | 25,020 |
| Income before income tax expense | 10,789 | 9,210 | 9,136 | 12,544 | 9,490 |
| Income tax expense | 3,530 | 2,621 | 2,546 | 3,811 | 2,537 |

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| | | | | | |
|------------|----------|----------|----------|----------|----------|
| Net income | \$ 7,259 | \$ 6,589 | \$ 6,590 | \$ 8,733 | \$ 6,953 |
|------------|----------|----------|----------|----------|----------|

| SELECTED PER SHARE DATA ON SHARES OF COMMON STOCK AT OR FOR THE YEARS ENDED DECEMBER 31, | <u>2007</u> | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> | <u>2002</u> | <u>% Change 2006 To 2007</u> | <u>Compounded Annual Growth 5 Years</u> |
|------------------------------------------------------------------------------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|----------------------------------------------|-----------------------------------------------------|
| Net income per share | \$2.02 | \$1.81 | \$1.79 | \$2.32 | \$1.82 | \$1.66 | 11.6% | 4.0% |
| Dividends declared | 0.97 | 0.96 | 0.96 | 0.93 | 0.92 | 0.92 | 1.0% | 1.1% |
| Tangible book value | 22.50 | 22.09 | 21.35 | 21.14 | 20.04 | 19.60 | 1.9% | 2.8% |
| Market price at 12/31 | 27.25 | 32.90 | 30.25 | 32.50 | 36.00 | 26.875 | -17.2% | 0.3% |
| Average shares outstanding (in thousands) | 3,595 | 3,642 | 3,689 | 3,772 | 3,821 | 3,928 | -1.3% | -1.8% |

| SELECTED RATIOS AT OR FOR THE YEARS ENDED DECEMBER 31, | <u>2007</u> | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> |
|-----------------------------------------------------------|-------------|-------------|-------------|-------------|-------------|
| Return on average assets | 0.95% | 0.91% | 0.92% | 1.17% | 0.93% |
| Return on average tier I equity (1) | 9.53% | 8.60% | 8.83% | 12.06% | 10.03% |
| Dividend yield at year end | 3.67% | 2.92% | 3.17% | 2.95% | 2.56% |
| Dividend payout | 47.02% | 51.94% | 52.68% | 39.31% | 49.62% |
| Total capital to risk adjusted assets | 15.78% | 17.11% | 18.06% | 18.77% | 17.61% |
| Tier I capital to risk adjusted assets | 13.84% | 15.12% | 16.02% | 16.71% | 15.70% |
| Tier I leverage ratio | 10.14% | 10.80% | 10.71% | 10.07% | 9.62% |
| Loans to deposits | 94.22% | 81.64% | 79.76% | 73.43% | 70.84% |
| Allowance for loan losses to total loans | 1.57% | 1.67% | 2.34% | 2.62% | 2.52% |
| Allowance for loan losses to non-performing loans | 236.58% | 221.15% | 106.97% | 92.74% | 79.90% |
| Non-performing loans to total loans | 0.66% | 0.76% | 2.18% | 2.82% | 3.16% |
| Net interest rate spread | 2.88% | 2.88% | 3.17% | 3.17% | 3.25% |
| Net interest margin | 3.71% | 3.69% | 3.74% | 3.65% | 3.74% |
| Efficiency ratio (2) | 70.03% | 74.77% | 71.09% | 63.24% | 62.57% |

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(1) Average Tier I Equity is average shareholders' equity less average goodwill and intangible assets and average accumulated other comprehensive income/loss.

(2) Efficiency ratio is operating expenses adjusted for amortization of intangible assets and stock donations divided by net interest income plus other operating income adjusted for non-taxable gains on stock donations.

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| UNAUDITED QUARTERLY DATA | Quarter Ended | | | |
|-----------------------------------------------------|---------------|----------|----------|----------|
| | 2007 | | | |
| (in thousands except per share data) | Mar. 31 | June 30 | Sept. 30 | Dec. 31 |
| Interest and dividend income | \$10,394 | \$10,820 | \$11,306 | \$11,355 |
| Interest expense | 4,275 | 4,424 | 4,695 | 4,545 |
| Net interest income | 6,119 | 6,396 | 6,611 | 6,810 |
| Provision for loan losses | 125 | 475 | 250 | 405 |
| Net interest income after provision for loan losses | 5,994 | 5,921 | 6,361 | 6,405 |
| Total other operating income | 3,803 | 4,258 | 4,271 | 4,296 |
| Total other operating expenses | 7,376 | 7,569 | 7,471 | 8,104 |
| Income before income tax expense | 2,421 | 2,610 | 3,161 | 2,597 |
| Income tax expense | 721 | 793 | 1,008 | 1,009 |
| Net Income | \$ 1,700 | \$ 1,817 | \$ 2,153 | \$ 1,588 |
| Basic and diluted earnings per share | \$ 0.47 | \$ 0.51 | \$ 0.60 | \$ 0.44 |
| | | | | |
| | Quarter Ended | | | |
| | 2006 | | | |
| | Mar. 31 | June 30 | Sept. 30 | Dec. 31 |
| Interest and dividend income | \$ 9,435 | \$ 9,813 | \$10,068 | \$10,309 |
| Interest expense | 3,358 | 3,719 | 3,889 | 4,113 |

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| | | | | |
|-----------------------------------------------------|----------|----------|----------|----------|
| Net interest income | 6,077 | 6,094 | 6,179 | 6,196 |
| Provision for loan losses | 125 | - | - | - |
| Net interest income after provision for loan losses | 5,952 | 6,094 | 6,179 | 6,196 |
| Total other operating income | 3,243 | 3,708 | 3,755 | 3,606 |
| Total other operating expenses | 6,957 | 7,292 | 7,329 | 7,945 |
| Income before income tax expense | 2,238 | 2,510 | 2,605 | 1,857 |
| Income tax expense | 641 | 713 | 768 | 499 |
| Net Income | \$ 1,597 | \$ 1,797 | \$ 1,837 | \$ 1,358 |
| Basic and diluted earnings per share | \$ 0.44 | \$ 0.49 | \$ 0.51 | \$ 0.38 |

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

The purpose of this discussion is to focus on information about the financial condition and results of operations of Chemung Financial Corporation. Reference should be made to the accompanying consolidated financial statements (including related notes) and the selected financial data appearing elsewhere in this report for an understanding of the following discussion and analysis.

This discussion contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. The Corporation intends its forward-looking statements to be covered by the safe harbor provisions for forward-looking statements in these sections. All statements regarding the Corporation's expected financial position and operating results, the Corporation's business strategy, the Corporation's financial plans, forecasted demographic and economic trends relating to the Corporation's industry and similar matters are forward-looking statements. These statements can sometimes be identified by the Corporation's use of forward-looking words such as "may," "will," "anticipate," "estimate," "expect," or "intend." The Corporation cannot promise that its expectations in such forward-looking statements will turn out to be correct. The Corporation's actual results could be materially different from expectations because of various factors, including changes in economic conditions or interest rates, credit risk, difficulties in managing our growth, competition, changes in the regulatory environment, and changes in general business and economic trends.

Description of Business

Chemung Financial Corporation, through its wholly owned subsidiaries, Chemung Canal Trust Company (the "Bank") and CFS Group, Inc., a financial services company, provides a wide range of banking, financing, fiduciary and other financial services within its local market areas.

Critical Accounting Policies, Estimates and Risks and Uncertainties

The Corporation's significant accounting policies are described in Note 1 to its audited consolidated financial statements appearing elsewhere in this report. Critical accounting policies include the areas where the Corporation has made what it considers to be particularly difficult, subjective or complex judgments in making estimates, and where these estimates can significantly affect the Corporation's financial results under different assumptions and conditions. The Corporation prepares its financial statements in conformity with accounting principles generally accepted in the United States. As a result, the Corporation is required to make certain estimates, judgements and assumptions that it believes are reasonable based upon the information available. These estimates, judgements

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and assumptions affect the reported amounts of assets and liabilities at the date of the financial statement and the reported amounts of revenue and expenses during the periods presented. Actual results could be different from these estimates.

Management considers the accounting policy relating to the allowance for loan losses to be a critical accounting policy given the inherent uncertainty in evaluating the level of the allowance required to cover probable credit losses inherent in the loan portfolio, and the material effect that such judgments can have on the Corporation's results of operations. While management's current evaluation of the allowance for loan losses indicates that the allowance is adequate, under adversely different conditions or assumptions, the allowance would need to be increased. For example, if historical loan loss experience significantly worsened or if current economic conditions significantly deteriorated, additional provisions for loan losses would be required to increase the allowance. In addition, the assumptions and estimates used in the internal review of the Corporation's non-performing loans and potential problem loans, and the associated evaluation of the related collateral coverage for these loans, have a significant impact on the overall analysis of the adequacy of the allowance for loan losses. While management has concluded that the current evaluation of collateral values is reasonable under the circumstances, if collateral evaluations were significantly lowered, the Corporation's allowance for loan losses policy would also require additional provisions for loan losses.

Management of Credit Risk - Loan Portfolio

The Corporation manages credit risk consistent with state and federal laws governing the making of loans through written policies and procedures; loan review to identify loan problems at the earliest possible time; collection procedures (continued even after a loan is charged off); an adequate allowance for loan losses; and continuing education and training to ensure lending expertise. Diversification by loan product is maintained through offering commercial loans, 1-4 family mortgages, and a full range of consumer loans.

The Corporation monitors its loan portfolio carefully. The Loan Committee of the Corporation's Board of Directors is designated to receive required loan reports, oversee loan policy, and approve loans above authorized individual and Senior Loan Committee lending limits. The Senior Loan Committee, consisting of the president & ceo, three executive vice presidents, business client division manager, retail client division manager, consumer loan manager, mortgage loan manager and credit manager, implements the Board-approved loan policy.

Competition

The Corporation is subject to intense competition throughout the southern tier of New York State and the northern tier of Pennsylvania in the lending and deposit gathering aspects of its business from commercial and thrift banking institutions, credit unions and other providers of financial services, such as brokerage firms, investment companies, insurance companies and Internet vendors. The Corporation also competes with non-financial institutions, including retail stores and certain utilities that maintain their own credit programs, as well as governmental agencies that make available loans to certain borrowers. Unlike the Corporation, many of these competitors are not subject to regulation as extensive as that of the Corporation and, as a result, they may have a competitive advantage over the Corporation in certain respects. Additionally, the pricing structure of credit unions is not encumbered by income taxes.

Competition for the Corporation's trust and investment services comes primarily from brokerage firms and independent investment advisors. These firms devote considerable resources toward gaining larger positions in these markets. The market value of trust assets under administration by the Corporation totaled approximately \$1.9 billion at year-end 2007. The Trust and Investment Division is responsible for the largest component of the Corporation's non-interest revenue.

Financial Condition

Consolidated assets at December 31, 2007 totaled \$788.9 million as compared to \$739.0 million at year-end 2006, an increase of \$49.9 million or 6.7%. As discussed in greater detail below, this increase is primarily the result of a \$61.9 million increase in loans, net of deferred fees and costs and unearned income, as well as increases in other intangible assets of \$4.7 million, cash and cash equivalents of \$2.8 million, Federal Home Loan Bank of New York ("FHLB") and Federal Reserve Bank stock of \$2.3 million and premises and equipment, net, of \$1.5 million. These increases were somewhat offset principally by a \$21.9 million decrease in the Corporation's investment securities portfolio.

As noted above, total loans, net of deferred fees and costs and unearned income increased \$61.9 million or 13.0% during 2007. Growth was exhibited in all segments of the loan portfolio, with total consumer loans increasing \$27.1 million, residential mortgages increasing \$26.0 million and commercial loans (including commercial mortgages) increasing \$8.7 million. The increase in consumer loans was principally due to a \$24.0 million increase in installment loans, due in large part to a significant increase in indirect auto financing originations during the second quarter of 2007, driven primarily by pricing. We do not anticipate growth in this area during 2008 to continue at the rate experienced during 2007. Additionally, outstanding balances on home equity loans and student loans increased \$2.6 million and \$551 thousand, respectively. The increase in both residential mortgages and commercial loans has been significantly impacted by the Corporation's expansion into Tompkins County, with total residential mortgages and commercial loans in this market increasing \$11.9 million and \$15.8 million, respectively. As regards residential mortgage growth, it is important to note that the Corporation has not, and will not offer subprime mortgage products.

A \$4.7 million increase in other intangible assets, net, resulted from the Corporation's acquisition on May 3, 2007 of the trust business of Partners Trust Bank ("Partners Trust") at a purchase price of approximately \$5.2 million or 1.49% of the fair value of the \$351 million of assets under administration at the time of the acquisition. The purchase price is being amortized over a 15 year period. At that time, the Corporation acquired \$351 million of trust business under administration at fair value. A \$2.8 million increase in cash and cash equivalents is primarily due to higher period end federal transit items and branch cash levels, while the \$1.5 million increase in premises and equipment, net, is

primarily the result of renovations at our main office and three of our branch facilities, as well as ongoing investments in technology and equipment.

The available for sale segment of the securities portfolio totaled \$165.3 million at December 31, 2007 compared to \$184.8 million at the end of 2006, a decrease of \$19.5 million, or 10.6%. At amortized cost, the available for sale portfolio was down \$22.7 million with unrealized appreciation related to the available for sale portfolio increasing \$3.2 million. The decrease in this portfolio was principally due to net paydowns on mortgage-backed securities totaling \$14.4 million, net maturities and calls of corporate bonds totaling \$4.8 million as well as a net \$3.7 million decrease in municipal bonds. Proceeds from the above were used to support the loan growth experienced during 2007. The increase in unrealized appreciation related to the available for sale portfolio was primarily due to the impact of a decline in mid to long-term interest rates since December 31, 2006 on the bond portfolio. The held to maturity segment of the portfolio, consisting primarily of local municipal obligations, totaled \$4.5 million as of December 31, 2007, a decrease of \$2.4 million since year-end 2006.

A \$2.3 million increase in FHLB and Federal Reserve Bank stock is due primarily to the Corporation's ownership of FHLB stock, which is reflective of the increase in FHLB borrowings since the end of 2006.

Total deposits were down \$12.5 million or 2.1%, from \$585.1 million at December 31, 2006 to \$572.6 million at December 31, 2007. Non-interest bearing deposits decreased \$6.1 million, due primarily to lower period end non-personal balances. Interest bearing deposits were down \$6.4 million, due primarily to a \$3.4 million decrease in total time deposits and a \$2.1 million decline in savings balances. The decrease in total time deposits reflects lower period end public fund time balances, offset to some extent primarily by an increase in personal investment certificates, while the decrease in savings was due to lower personal account balances. A \$3.8 million decrease in securities sold under agreements to repurchase reflects a reduction in repurchase agreements funded through the FHLB.

With deposits lower than year ago balances, and the growth in loans exceeding cash flow available from the decrease in the securities portfolio, overnight borrowings under the Corporation's line of credit with the FHLB increased \$54.5 million since December 31, 2006.

A \$5.8 million increase in other liabilities was due in large part to increases in net deferred tax liabilities and income taxes payable.

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BALANCE SHEET COMPARISONS

| (in millions) | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | % Change 2006 to 2007 | Compounded Annual Growth 5 Years |
|-----------------------|---------|---------|---------|---------|---------|---------|--------------------------------|-------------------------------------------|
| Average Balance Sheet | | | | | | | | |
| Total Assets | \$767.0 | \$722.0 | \$715.3 | \$746.1 | \$748.2 | \$745.9 | 6.2% | 0.6% |

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| | | | | | | | | |
|------------------------------------------------------------|-------|-------|-------|-------|-------|-------|--------|-------|
| Earning Assets (1) | 698.6 | 665.9 | 661.3 | 691.9 | 690.9 | 685.1 | 4.9% | 0.4% |
| Loans, net of deferred fees and costs, and unearned income | 520.0 | 449.7 | 403.4 | 388.2 | 412.6 | 428.8 | 15.6% | 3.9% |
| Investments (2) | 178.6 | 216.2 | 257.9 | 303.7 | 278.3 | 256.3 | -17.4% | -7.0% |
| Deposits | 592.6 | 568.3 | 530.0 | 541.8 | 553.2 | 545.7 | 4.3% | 1.7% |
| Wholesale funding (3) | 72.2 | 54.3 | 87.5 | 108.1 | 101.7 | 105.5 | 33.0% | -7.3% |
| Tier I equity (4) | 76.2 | 76.6 | 74.6 | 72.4 | 69.3 | 69.2 | -0.5% | 1.9% |

(1) Average earning assets include securities available for sale and securities held to maturity based on amortized cost, loans net of deferred origination fees and costs and unearned income, interest-bearing deposits, Federal Home Loan Bank stock, Federal Reserve Bank stock and federal funds sold.

(2) Average balances for investments include securities available for sale and securities held to maturity, based on amortized cost, Federal Home Loan Bank stock, Federal Reserve Bank stock, federal funds sold and interest-bearing deposits.

(3) Wholesale funding includes Federal Home Loan Bank advances and securities sold under agreements to repurchase funded through the Federal Home Loan Bank.

(4) Average shareholders' equity less goodwill, intangible assets and accumulated other comprehensive income/loss.

| (in millions) | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | % Change 2006 to 2007 | Compounded Annual Growth 5 Years |
|------------------------------------------------------------|---------|---------|---------|---------|---------|---------|-----------------------|----------------------------------|
| Ending Balance Sheet | | | | | | | | |
| Total Assets | \$788.9 | \$739.0 | \$718.0 | \$722.5 | \$747.2 | \$751.2 | 6.8% | 1.0% |
| Earning Assets(1) | 707.5 | 668.5 | 666.1 | 669.5 | 690.0 | 685.3 | 5.8% | 0.6% |
| Loans, net of deferred fees and costs, and unearned income | 539.5 | 477.7 | 418.7 | 381.5 | 390.4 | 432.3 | 12.9% | 4.5% |
| Allowance for loan losses | 8.5 | 8.0 | 9.8 | 9.9 | 9.8 | 7.7 | 5.9% | 1.9% |
| Investments (2) | 176.0 | 190.8 | 247.3 | 292.7 | 309.1 | 265.2 | -7.8% | -7.9% |
| Deposits | 572.6 | 585.1 | 524.9 | 519.6 | 551.1 | 541.8 | -2.1% | 1.1% |

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| | | | | | | | | |
|----------------------|-------|------|------|-------|------|-------|-------|-------|
| Wholesale funding(3) | 104.9 | 55.4 | 94.8 | 108.0 | 98.5 | 113.3 | 89.4% | -1.5% |
| Tangible equity (4) | 81.0 | 79.8 | 78.3 | 78.9 | 76.3 | 75.4 | 1.5% | 1.4% |

1. Earning assets include securities available for sale and securities held to maturity based on amortized cost, loans net of deferred origination fees and costs and unearned income, interest-bearing deposits, Federal Home Loan Bank stock, Federal Reserve Bank stock and federal funds sold.
2. Investments include securities available for sale, at estimated fair value, securities held to maturity, at amortized cost, Federal Home Loan Bank stock, Federal Reserve Bank stock, federal funds sold and interest-bearing deposits.
3. Wholesale funding includes Federal Home Loan Bank advances and securities sold under agreements to repurchase funded through the Federal Home Loan Bank.
4. Shareholders' equity less goodwill and intangible assets.

Securities

The Board-approved Funds Management Policy includes an investment portfolio policy which requires that, except for local municipal obligations that are sometimes not rated or carry ratings above "Baa" but below "A" by Moody's or Standard & Poors, debt securities purchased for the bond portfolio must carry a minimum rating of "A". Marketable securities are classified as *Available for Sale*, while local direct investments in municipal obligations are classified as *Held to Maturity*. The *Available for Sale* portfolio at December 31, 2007 totaled \$165.3 million compared to \$184.8 million a year earlier. At year-end 2007, the total net unrealized appreciation in the securities available for sale portfolio was \$8.0 million, compared to \$4.8 million a year ago. The components of this change are set forth below.

| (in thousands) | 2007 Amortized Cost | 2007 Estimated Fair Value | Unrealized Appreciation (Depreciation) | 2006 Amortized Cost | 2006 Estimated Fair Value | Unrealized Appreciation (Depreciation) |
|-------------------------------------------------------------------------|---------------------------|---------------------------------|----------------------------------------------|---------------------------|---------------------------------|----------------------------------------------|
| Securities Available for Sale | | | | | | |
| Obligations of U.S. Government and U.S Government sponsored enterprises | \$ 81,752 | \$ 81,944 | \$ 192 | \$ 81,735 | \$ 80,134 | \$ (1,601) |
| Mortgage-backed securities | 57,006 | 56,285 | (721) | 71,427 | 69,206 | (2,221) |
| Obligations of states and political subdivisions | 13,372 | 13,483 | 111 | 17,022 | 17,084 | 62 |
| Corporate bonds and notes | 4,352 | 4,441 | 89 | 9,124 | 9,275 | 151 |
| Corporate stocks | 828 | 9,168 | 8,340 | 729 | 9,131 | 8,402 |
| Totals | \$157,310 | \$165,321 | \$ 8,011 | \$180,037 | \$184,830 | \$ 4,793 |

Included in the preceding table are 35,406 shares of SLM Corp. (formerly USA Education, Inc.) at a cost basis of approximately \$1 thousand and estimated fair value of \$713 thousand. These shares were acquired by the bank as preferred shares of Student Loan Marketing Association, or Sallie Mae, a permitted exception to the

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Government regulation banning bank ownership of equity securities in the original capitalization of the U.S. Government Agency. Later, the shares were converted to common stock as Sallie Mae recapitalized. Additionally, at December 31, 2007, the Corporation held marketable equities totaling \$827 thousand at cost, with a total estimated fair value of \$8.455 million.

Non-marketable equity securities carried by the Corporation at December 31, 2007 include 10,935 shares of Federal Reserve Bank stock and 53,548 shares of the Federal Home Loan Bank of New York stock. They are carried at their cost of \$547 thousand and \$5.355 million, respectively. The fair value of these securities is assumed to approximate their cost. The number of shares of these two investments is regulated by regulatory policies of the respective institutions.

Asset Quality

Non-performing loans at year-end 2007 totaled \$3.573 million as compared to \$3.610 million at year-end 2006, a decrease of \$37 thousand. This reduction resulted from a \$635 thousand decrease in non-accrual loans, offset by increases in troubled debt restructurings and accruing loans past due 90 days or more totaling \$501 thousand and \$97 thousand, respectively. The decrease in non-accrual loans was primarily due to a \$613 thousand reduction in non-accrual commercial loans. As compared to December 31, 2006, commercial loans totaling \$614 thousand were placed in non-accrual status, offset by upgrades totaling \$310 thousand and principal reductions of \$917 thousand. Additionally, since December 31, 2006, non-accruing consumer loans and mortgages have decreased \$90 thousand and \$11 thousand, respectively, partially offset by a \$78 thousand increase in non-accruing home equity loans. A \$501 thousand increase in troubled debt restructurings resulted from the restructuring of two commercial relationships during the third quarter of 2007, while a \$97 thousand increase in accruing loans past due 90 days or more is due to higher mortgage and consumer loan delinquencies.

At December 31, 2007 the Corporation had no properties classified as Other Real Estate Owned ("OREO"). The \$1.819 million decrease since December 31, 2006 resulted primarily from the sale of two commercial properties during the first half of 2007.

Non-Performing Assets

The following table summarizes the Corporation's non-performing assets (in thousands of dollars):

| <u>December 31,</u> | 2007 | 2006 | 2005 | 2004 | 2003 |
|---------------------|----------|----------|----------|-----------|-----------|
| Non-accrual loans | \$ 2,225 | \$ 2,860 | \$ 8,727 | \$ 10,507 | \$ 11,727 |

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| | | | | | |
|-----------------------------------------|----------|----------|----------|-----------|-----------|
| Troubled debt restructurings | 830 | 329 | 106 | - | 277 |
| Accruing loans past due 90 days or more | 518 | 421 | 308 | 258 | 327 |
| Total non-performing loans | \$ 3,573 | \$ 3,610 | \$ 9,141 | \$ 10,765 | \$ 12,331 |
| Other real estate owned | - | 1,819 | 79 | 104 | 357 |
| Total non-performing assets | \$ 3,573 | \$ 5,429 | \$ 9,220 | \$ 10,869 | \$ 12,688 |

Information with respect to interest income on non-accrual and troubled debt restructured loans for the years ended December 31 is as follows (in thousands of dollars):

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|--------------------------------------------------------------------|-------------|-------------|-------------|
| Interest income that would have been recorded under original terms | \$ 235 | \$ 359 | \$ 768 |
| Interest income recorded during the period | \$ 59 | \$ 29 | \$ 26 |

In addition to non-performing loans, as of December 31, 2007, the Corporation, through its credit administration and loan review functions, has identified 14 commercial relationships totaling \$11.1 million in potential problem loans, as compared to \$12.0 million (15 relationships) at December 31, 2006. This decrease was primarily due to ongoing principal payments, the payoff of one loan totaling \$257 thousand at December 31, 2006 and the downgrade of one loan totaling \$79 thousand at December 31, 2006 to non-accrual status. Potential problem loans are loans that are currently performing, but where known information about possible credit problems of the related borrowers causes management to have serious doubts as to the ability of such borrowers to comply with the present loan repayment terms, and which may result in the disclosure of such loans as non-performing at some time in the future. At the Corporation, potential problem loans are typically loans that are performing but are classified in the Corporation's loan rating system as "substandard." Management cannot predict the extent to which economic conditions may worsen or other factors which may impact borrowers and the potential problem loans. Accordingly, there can be no assurance that other loans will not become 90 days or more past due, be placed on non-accrual, become restructured, or require increased allowance coverage and provisions for loan losses.

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Management's evaluation of the adequacy of the allowance for loan losses is performed on a periodic basis and takes into consideration such factors as the historical loan loss experience, review of specific problem loans (including evaluation of the underlying collateral) changes in the composition and volume of the loan portfolio, overall portfolio quality, and current economic conditions that may affect the borrowers' ability to pay. The provision for loan losses during 2007 and 2006 totaled \$1.255 million and \$125 thousand, respectively. This \$1.130 million increase reflects both loan growth as well as charge-offs during 2007 of commercial loans for which no prior allocation to the allowance for loan losses had been made. Additionally, during 2006, the provision for loan losses was reduced significantly when a commercial loan for which a \$2.022 million specific reserve had been allocated was paid off, resulting in a charge-off of only \$208 thousand at that time. At December 31, 2007, the Corporation's allowance for loan losses totaled \$8.453 million, resulting in a coverage ratio of allowance to non-performing loans of 236.6%. The allowance for loan losses is an amount that management believes will be adequate to absorb probable loan losses on existing loans. Net loan charge-offs during 2007 totaled \$785 thousand or 0.15% of average outstanding loans,

compared to \$1.920 million or 0.43% of average outstanding loans in 2006. This \$1.135 million decrease was due to a \$1.159 million reduction in net commercial loan charge-offs, with commercial loan charge-offs decreasing \$866 thousand, while recoveries on previously charged-off commercial loans increased \$293 thousand. The allowance for loan losses to total loans at December 31, 2007 was 1.57% as compared to 1.67% as of December 31, 2006.

SUMMARY OF LOAN LOSS EXPERIENCE

The following summarizes the Corporation's loan loss experience for each year in the five-year period ended December 31, 2007 (in thousands of dollars):

| | <u>Years Ended December 31,</u> | | | | |
|-----------------------------------------------------------------------|---------------------------------|-------------|-------------|-------------|-------------|
| | <u>2007</u> | <u>2006</u> | <u>2005</u> | <u>2004</u> | <u>2003</u> |
| Allowance for loan losses at beginning of year | \$ 7,983 | \$ 9,778 | \$ 9,983 | \$ 9,848 | \$ 7,674 |
| Charge-offs: | | | | | |
| Commercial, financial and agricultural | 793 | 1,659 | 1,246 | 1,060 | 2,182 |
| Real estate mortgages | 13 | 4 | 11 | 3 | 2 |
| Consumer loans | 482 | 482 | 516 | 577 | 630 |
| Home equity | - | - | 2 | - | 6 |
| Total | 1,288 | 2,145 | 1,775 | 1,640 | 2,820 |
| Recoveries: | | | | | |
| Commercial, financial and agricultural | 331 | 38 | 13 | 53 | 83 |
| Real estate mortgages | - | - | - | - | 2 |
| Consumer loans | 172 | 187 | 257 | 222 | 209 |
| Total | 503 | 225 | 270 | 275 | 294 |
| Net charge-offs | 785 | 1,920 | 1,505 | 1,365 | 2,526 |
| Provision charged to operations | 1,255 | 125 | 1,300 | 1,500 | 4,700 |
| Allowance for loan losses at end of year | \$ 8,453 | \$ 7,983 | \$ 9,778 | \$ 9,983 | \$ 9,848 |
| Ratio of net charge-offs during year to average loans outstanding (1) | ..15% | ..43% | ..37% | ..35% | ..61% |

(1) Daily balances were used to compute average outstanding loan balances.

Liquidity and Capital Resources

Liquidity management involves the ability to meet the cash flow requirements of deposit clients, borrowers, and the operating, investing and financing activities of the Corporation. The Corporation uses a variety of resources to meet its liquidity needs. These include short term investments, cash flow from lending and investing activities, core-deposit growth and non-core funding sources, such as time deposits of \$100,000 or more, securities sold under agreements to repurchase and other borrowings.

The Corporation is a member of the Federal Home Loan Bank of New York ("FHLB"), which allows it to access borrowings which enhance management's ability to satisfy future liquidity needs. At December 31, 2007, the Corporation maintained a \$149.4 million line of credit with the FHLB, as compared to \$144.4 million at December 31, 2006.

During 2007, cash and cash equivalents increased \$2.8 million as compared to an increase of \$1.0 million during 2006. In addition to cash provided by operating activities, other primary sources of cash during 2007 included a net increase in FHLB advances of \$54.5 million, proceeds from maturities and principal payments on securities totaling \$36.9 million and proceeds from the sale of OREO totaling \$2.4 million. Proceeds from the above were used primarily to fund a \$62.2 million net increase in loans, a \$12.5 million decrease in deposits, purchases of securities totaling \$11.8 million, a \$5.3 million purchased intangible related to the purchase

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of the trust business of Partners Trust, purchases of premises and equipment totaling \$4.1 million, a net reduction of securities sold under agreements to repurchase in the amount of \$3.8 million, the payment of cash dividends totaling \$3.4 million and a net increase in FHLB and Federal Reserve Bank stock of \$2.3 million.

In addition to cash provided by operating activities, other primary sources of cash during 2006 included proceeds from maturities and principal payments on securities totaling \$53.9 million and an increase in deposits of \$60.2 million. Cash generated during 2006 was used primarily to fund a \$61.3 million increase in net loans as well as net reductions in securities sold under agreements to repurchase and advances from the Federal Home Loan Bank in the amounts of \$25.8 million and \$12.9 million, respectively. Other significant uses of cash during 2006 included a \$10.0 million contribution to the Corporation's defined benefit pension plan, \$5.6 million for the purchase of premises and equipment, purchases of securities totaling \$3.7 million, the payment of cash dividends in the amount of \$3.4 million, and the purchase of treasury shares totaling \$2.3 million.

The Corporation continues to maintain a strong capital position. As of December 31, 2007, the Corporation's ratio of Total Capital to Risk Weighted Assets was 15.78% compared with 17.11% a year earlier. The Corporation's leverage ratio (Tier I Capital/Average Assets) was 10.14% at December 31, 2007 and 10.80% at December 31, 2006. These ratios are in excess of the requirements for being considered "well capitalized" by the FDIC, the Federal Reserve and the New York State Banking Department.

Cash dividends declared during 2007 totaled \$3.413 million or \$0.97 per share versus \$3.422 million or \$0.96 per

share in 2006 and \$3.471 million or \$0.96 per share in 2005. Dividends declared during 2007 amounted to 47.0% of net income compared to 51.9% and 52.7% of 2006 and 2005 net income, respectively. It is management's objective to continue generating sufficient capital internally, while retaining an adequate dividend payout ratio to our shareholders.

When shares of the Corporation become available in the market, we may purchase them after careful consideration of our capital position. On November 15, 2006, the Corporation's Board of Directors authorized the repurchase of up to 180,000 shares, or approximately 5% of its then outstanding common shares, either through open market or privately negotiated transactions over a two-year period. Since the inception of this share repurchase program in November of 2006, a total of 52,125 treasury shares had been purchased through December 31, 2007. During 2007, the Corporation purchased 40,325 shares at a total cost of \$1.239 million or an average price of \$30.73 per share. Additionally, during 2007, 23,264 shares were re-issued from treasury to fund the stock component of directors' 2006 compensation, distributions under the Corporation's directors' deferred stock plan, a stock grant to an executive officer and funding for the Corporation's profit sharing, savings and investment plan. During 2006, 73,496 shares were purchased at a total cost of \$2.265 million or an average price of \$30.82 per share, and in 2005 there were 71,065 shares purchased at a total cost of \$2.288 million (average of \$32.20 per share).

Off-Balance Sheet Arrangements

In the normal course of operations, the Corporation engages in a variety of financial transactions that, in accordance with generally accepted accounting principles, are not recorded in the financial statements. The Corporation is also a party to certain financial instruments with off balance sheet risk such as commitments under standby letters of credit, unused portions of lines of credit and commitments to fund new loans. The Corporation's policy is to record such instruments when funded. These transactions involve, to varying degrees, elements of credit, interest rate and liquidity risk. Such transactions are generally used by the Corporation to manage clients' requests for funding and other client needs.

As of December 31, 2007, the Corporation has off-balance sheet arrangements as follows (in thousands of dollars):

| | <u>Commitment Maturity by Period</u> | | | | |
|----------------------------------------|--------------------------------------|-------------------------|---------------------|---------------------|--------------------------|
| | <u>Total</u> | <u>Less than 1 Year</u> | <u>1 to 3 Years</u> | <u>3 to 5 Years</u> | <u>More than 5 Years</u> |
| Standby letters of credit | \$ 11,487 | \$ 8,446 | \$ 206 | \$ 40 | \$ 2,795 |
| Unused portions of lines of credit (1) | 78,647 | 78,647 | - | - | - |
| Commitments to fund new loans | 10,620 | 10,620 | - | - | - |
| Total | \$ 100,754 | \$ 97,713 | \$ 206 | \$ 40 | \$ 2,795 |

(1) Not included in this total are unused portions of home equity lines of credit, credit card lines and consumer overdraft protection lines of credit, since no contractual maturity dates exist for these types of loans. Commitments to outside parties under these lines of credit were \$26,522,635, \$17,019,871 and \$2,131,057, respectively, at December 31, 2007.

Contractual Obligations

As of December 31, 2007, the Corporation is contractually obliged under long-term agreements as follows (in thousands of dollars):

| | Total | Payments Due by Period | | | |
|---------------------------------------------------------|-----------|------------------------|--------------|--------------|-------------------|
| | | Less than 1 Year | 1 to 3 Years | 3 to 5 Years | More than 5 Years |
| Time Deposits (Note 7) | \$227,171 | \$165,443 | \$49,222 | \$12,341 | \$ 165 |
| Federal Home Loan Bank advances (Note 9) | 82,400 | 62,400 | - | 10,000 | 10,000 |
| Securities sold under agreements to repurchase (Note 8) | 31,212 | 18,712 | - | 2,500 | 10,000 |
| Agreement to purchase 3 branches from M and T Bank | 8,741 | 8,741 | - | - | - |
| Operating leases | 3,271 | 334 | 476 | 400 | 2,061 |
| Other | 2,145 | 1,057 | 596 | 421 | 71 |
| Total | \$354,940 | \$256,687 | \$ 50,294 | \$ 25,662 | \$ 22,297 |

Results of Operations 2007 vs. 2006

Consolidated net income in 2007 totaled \$7.259 million, an increase of 10.2% compared to \$6.589 million in 2006. Earnings per share increased 11.6% from \$1.81 per share to \$2.02 per share on 47,372 fewer average shares outstanding. Dividends declared per share increased from \$0.96 to \$0.97 per share.

As discussed below, this improvement in earnings resulted from higher net interest income and non-interest income, partially offset by increases in the provision for loan losses and operating expenses, as well as a higher effective tax rate.

Net interest income increased \$1.390 million or 5.7%, from \$24.546 million in 2006 to \$25.936 million in 2007, with the net interest margin increasing 2 basis points to 3.71%. Average earning assets increased \$32.7 million or 4.9%, as a \$70.3 million or 15.6% increase in average loans was somewhat offset primarily by a \$36.6 million or 17.1% decrease in the average securities portfolio, as proceeds from the securities decrease were used to support loan growth during 2007. The increase in average loans reflects growth in all portfolio segments, with average mortgages increasing \$35.6 million, average consumer loans increasing \$26.7 million and average commercial loans up \$8.0 million. While average earning assets increased 4.9%, total interest and dividend income was up \$4.251 million or 10.7% as the average yield increased 33 basis points to 6.28%, due in large part to loan growth.

Total average funding liabilities, including non-interest bearing demand deposits, increased \$42.6 million or 6.7% compared to the 2006 averages due to a \$24.3 million increase in average deposits and an \$18.3 million increase in other borrowings. The increase in average deposits was principally due to a \$19.2 million increase in average time deposits, as well as increases in average demand deposit and insured money market balances of \$6.7 million and \$4.5 million, respectively. These increases were somewhat offset primarily by a \$5.5 million decrease in average savings account balances. The increase in other borrowings reflects higher average term and overnight advances from the FHLB, these borrowings being utilized to fund loan growth. While average interest bearing liabilities increased 7.3%, total interest expense increased 19.0%, with the average cost of interest bearing liabilities increasing 33 basis points to 3.40%.

As discussed more fully under the "Asset Quality" section of this discussion, the provision for loan losses increased \$1.130 million from \$125 thousand in 2006 to \$1.255 million in 2007, and reflects management's evaluation of the adequacy of the allowance for loan losses based upon a number of factors including an analysis of historical loss factors, the evaluation of collateral, recent charge-off experience, overall credit quality and loan growth.

Non-interest income during 2007 increased \$2.317 million or 16.2% from \$14.312 million to \$16.629 million. This increase was impacted to a great extent by a \$1.444 million increase in Trust and Investment Center fee income as well as a \$668 thousand increase in gains on the sale of Other Real Estate Owned ("OREO"), these being properties that had been acquired through foreclosure proceedings. The increase in Trust and Investment Center fee income was primarily due to increased

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revenue related to the Corporation's acquisition in May 2007 of the trust business of Partners Trust, as well as higher retirement services and investment management revenue, while the increase in gains on the sale of OREO resulted principally from the sale of two commercial properties that had been foreclosed on during 2006. In addition to the above, other significant increases during 2007 included a \$306 thousand increase in service charges on deposit accounts, a \$114 thousand increase in credit card merchant earnings, a \$111 thousand increase in debit card interchange fee income and a \$101 thousand increase in cash management fee income. These increases were offset to some extent primarily by a \$280 thousand decrease in revenue from the Corporation's equity investment in Cephas Capital Partners, LP, a Small Business Investment Company limited partnership, and a \$204 thousand decrease in revenue generated from OREO, this decrease associated with the aforementioned sale of two commercial properties.

Operating expenses during 2007 increased \$997 thousand or 3.4%, from \$29.523 million to \$30.520 million. The principal factors in this increase include \$1.786 million increase in salaries and wages, as well as increases in net occupancy expenses and amortization of intangible assets totaling \$275 thousand and \$236 thousand, respectively.

The increase in salaries and wages was primarily related to merit increases effective in January 2007, the addition to staff in conjunction with the purchase of the trust business of Partners Trust and higher levels of incentive compensation. The increase in net occupancy costs was primarily due to higher depreciation, maintenance and rent expense, while higher amortization expense was related to amortization of the purchase intangible related to the trust relationship acquisition. The above increases were offset primarily by a \$668 thousand decrease in pension and other employee benefits, a \$495 thousand decrease in OREO expenses and a \$167 thousand decrease in data processing costs. The reduction in the cost of pension and other employee benefits resulted primarily from decreases in expenses associated with the Corporation's defined benefit pension plan and post-retirement medical plan totaling \$783 thousand and \$200 thousand, respectively, offset to some extent primarily by increases in health insurance and payroll taxes of \$183 thousand and \$82 thousand, respectively. The decrease in pension expense is primarily due to an increase in the expected return on plan assets, due in large part to the Corporation's \$10.0 million contribution to the plan in 2006, while the reduction in post-retirement medical benefits resulted from an amendment to this plan effective July 1, 2006. Prior to this amendment, all retirees age 55 or older were eligible for coverage under the Corporation's self insured plan, contributing 40% of the cost of the coverage. Under the amended plan, coverage for retirees age 65 and older who reside in the designated plan area is provided under a group plan offered through Blue Cross, Blue Shield called Medicare Blue PPO, with the retiree paying 100% of the cost of coverage. Current retirees age 65 and older who reside outside of the designated area, as well as current and future retirees between the ages of 55 and 65, will continue to be eligible for coverage under the Corporation's self insured plan, with the retiree contribution increasing from 40% to 50%. The decrease in OREO expenses is due to the sale of two commercial properties during 2007, while the reduction in data processing costs is related to the fact that during the fourth quarter of 2006, the Corporation changed its ATM processing vendor, and at that time incurred a \$191 thousand termination fee with its prior vendor.

A \$909 thousand increase in income tax expense and the increase in the effective tax rate from 28.5% to 32.7% reflects an increase in pre-tax income and a decrease in the relative percentage of tax-exempt income to pre-tax income, as well as an increase in New York State tax expense primarily due to the implications of New York State minimum tax and a change in the New York State tax rate.

Results of Operations 2006 vs. 2005

Consolidated net income for 2006 totaled \$6.589 million, essentially unchanged from 2005 net income of \$6.590 million, while earnings per share increased 1.1% from \$1.79 per share to \$1.81 per share on 49,932 fewer average shares outstanding. Dividends declared per share were unchanged at \$0.96 per share.

As discussed below, while net income for 2006 was impacted by higher operating expenses and lower net interest income, these factors were offset by higher non-interest income as well as a reduction in the provision for loan losses.

Despite a \$4.6 million increase in average earning assets as compared to 2005, net interest income declined \$191 thousand or 0.8% from \$24.737 million in 2005 to \$24.546 million in 2006, with the net interest margin decreasing 5 basis points from 3.74% to 3.69%. This reduction has been influenced by higher short term interest rates and a flat to inverted yield curve throughout 2006, with a 51 basis

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point increase in the yield on average earning assets from 5.44% to 5.95%, offset by an 80 basis point increase in the cost of average interest bearing liabilities from 2.27% to 3.07%. The increase in average earning assets resulted from a

\$46.3 million increase in average loans offset by a \$32.5 million decrease in the average securities portfolio and a \$9.3 million decrease in average federal funds sold and interest bearing deposits. The increase in average loans reflects growth in all portfolio segments, with average mortgages increasing \$22.2 million, and average consumer loans and commercial loans increasing \$12.9 million and \$11.2 million, respectively. The decrease in average securities has been impacted by the flat to inverted yield curve, and the resulting

inability to leverage quality securities purchases at acceptable interest rate spreads.

Total average funding liabilities, including non-interest bearing demand deposits, increased \$5.6 million or 0.9% compared to the 2005 averages, as a \$38.2 million increase in average deposits and a \$7.8 million increase in average overnight borrowings under the Corporation's line of credit with the FHLB, were partially offset by a \$29.3 million decrease in average term repurchase agreements funded through the FHLB and an \$11.7 million decrease in average term advances from the FHLB. While average non-interest bearing demand deposits increased \$7.0 million, average interest bearing deposits were up \$31.2 million. The increase in average interest bearing

deposits was reflected primarily in higher average time deposits and insured money market accounts of \$37.8 million and \$7.0 million, respectively, somewhat offset by an \$8.6 million decrease in average savings balances and a \$5.0 million decrease in average Now accounts. The decrease in average securities sold under agreements to repurchase and term advances from the FHLB reflects the maturity or call of advances that had been utilized to leverage securities purchases. While average interest bearing liabilities decreased \$1.4 million or 0.3%, interest expense increased \$3.857 million or 34.4%, as the average cost of interest bearing liabilities rose 80 basis points, reflective of the fact that the increase in average deposits was primarily due to an increase in higher cost time and insured money market deposits.

In 2006, the provision for loan losses totaled \$125 thousand compared to \$1.300 million the prior year, a decrease of \$1.175 million. This decrease reflects the significant decrease in non-performing relationships during 2006, as well as the fact that as of December 31, 2005, the Corporation had allocated a specific reserve of \$2.022 million related to a \$5.5 million potential problem loan due to concerns about a probable collateral shortfall on this loan. During the fourth quarter of 2006, this loan was paid off, resulting in a charge-off of \$208 thousand.

Non-interest income during 2006 increased \$1.298 million or 10.0% from \$13.014 million to \$14.312 million. This increase was impacted to a great extent by a \$566 thousand increase in service charges on deposit accounts as well as a \$282 thousand increase in revenue derived from Other Real Estate Owned ("OREO"), these being properties acquired through foreclosure proceedings. The increase in service charges was due primarily to an increase in fees for insufficient funds, as this fee was increased during the first quarter of 2006. The increase in revenue from OREO was due principally to the operation of a golf course which the Corporation acquired in the first quarter of 2006. While this property was listed for sale, management determined that the marketability of the course would be enhanced by its ongoing operation, and the revenue received would help to offset maintenance costs which would have been incurred whether or not the golf course was in operation. In addition to the foregoing, other significant increases during 2006 included a \$251 thousand increase in revenue from the Corporation's equity investment in Cephaz Capital Partners, LP, a Small Business Investment Company limited partnership, a \$130 thousand increase in debit card interchange fee income and a \$43 thousand increase in credit card merchant revenue. A \$194 thousand decrease in trust and investment services revenue was due in large part to a decline in revenue from estates resulting from the settlement of a large estate during the fourth quarter of 2005.

Operating expenses during 2006 increased \$2.208 million or 8.1%, from \$27.315 million to \$29.523 million. This increase was partially driven by the Corporation's expansion into Tompkins and Broome counties, as the Corporation opened a full service office in Tompkins County and a representative office in Broome County during the fourth

quarter of 2005, with a second full service office in Tompkins County opened during the second quarter of 2006. Expenses related to these offices totaled approximately \$1.335 million during 2006 compared to \$384 thousand in 2005, an increase of \$951 thousand. Additionally, during the fourth quarter of 2006, the Corporation incurred charges related to the replacement of its

mainframe computer system and a change in ATM processing vendors in the amounts of \$153 thousand and \$191 thousand, respectively. Items that had the greatest impact on the total operating expense increase included a \$496 thousand increase in salaries and wages, a \$640 thousand increase in data processing costs, a \$581 thousand increase in costs associated with OREO and a \$378 thousand increase in net occupancy expenses. The increase in salaries and wages is primarily related to merit increases effective in January of 2006, as well as increased staffing related to the above mentioned expansions. The increase in data processing costs is reflected primarily in higher credit and debit card processing costs, as well as an increase in software maintenance and charges mentioned above related to the early termination of a contract with our former ATM processing vendor. The increase in OREO expenses is primarily due to the aforementioned operation of the golf course acquired through foreclosure. The occupancy cost increase was primarily due to the above mentioned expansion as well as higher depreciation, maintenance, utilities and real estate taxes associated with other properties. The increases noted above were somewhat offset primarily by a \$226 thousand decrease in pension and other employee benefits, as reductions in post-retirement medical benefits and health insurance costs of \$209 thousand and \$215 thousand, respectively, were somewhat offset primarily by a \$124 thousand increase in pension expense. The reduction in post-retirement medical benefits resulted from an amendment to this plan effective July 1, 2006. Prior to this amendment, all retirees age 55 or older were eligible for coverage under the Corporation's self insured plan, contributing 40% of the cost of the coverage. Under the amended plan, coverage for retirees age 65 and older who reside in the designated plan area is provided under a group plan offered through Blue Cross, Blue Shield called Medicare Blue PPO, with the retiree paying 100% of the cost of coverage. Current retirees age 65 and older who reside outside of the designated area, as well as current and future retirees between the ages of 55 and 65, will continue to be eligible for coverage under the Corporation's self insured plan, with the retiree contribution increasing from 40% to 50%. The decrease in health insurance costs during 2006 reflects much improved experience under the Corporation's self insured plan. As noted above, these decreases were somewhat offset by a \$124 thousand increase in pension expense. This increase was due primarily to an increase in amortization of prior years' unrecognized actuarial losses. During the fourth quarter of 2006, the Corporation made a \$10.0 million tax-deductible contribution to the plan. It is expected that this contribution will significantly decrease future years' pension expense. With this contribution, plan assets at December 31, 2006 exceeded the projected benefit obligation by approximately \$9.9 million.

A \$75 thousand increase in income tax expense reflects an increase in pre-tax income, as well as an increase in the Corporation's effective tax rate from 27.9% to 28.5%. While the state tax expense decreased due primarily to a higher New York State mortgage recording tax credit, this was offset by an increase in federal income taxes resulting from a reduced level of tax exempt interest income as well as the lower state income tax deduction.

EARNINGS FOR THE YEARS ENDED DECEMBER 31,

| (in thousands) | 2007 | 2006 | 2005 | 2004 | 2003 | 2002 | % Change 2006 to 2007 | Compounded Annual Growth 5 Years |
|----------------|------|------|------|------|------|------|--------------------------------|-------------------------------------------|
| | | | | | | | | |

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| | | | | | | | | |
|-----------------------------------------------------|----------|----------|----------|----------|----------|----------|--------|---------|
| Net interest income | \$25,936 | \$24,546 | \$24,737 | \$25,257 | \$25,864 | \$27,069 | 5.7% | -0.9% |
| Provision for loan losses | 1,255 | 125 | 1,300 | 1,500 | 4,700 | 3,283 | 904.0% | -17.5% |
| Net interest income after provision for loan losses | 24,681 | 24,421 | 23,437 | 23,757 | 21,164 | 23,786 | 1.1% | 0.7% |
| Other operating income: | | | | | | | | |
| Trust and investment services income | 6,345 | 4,901 | 5,095 | 4,725 | 4,501 | 4,513 | 29.5% | 7.1% |
| Securities gains (losses), net | 10 | 27 | 6 | 602 | 1,185 | (459) | -63.0% | -146.5% |
| Net gains on sales of loans held for sale | 98 | 103 | 107 | 983 | 245 | 9 | -4.9% | 61.2% |
| Other income | 10,176 | 9,281 | 7,806 | 7,958 | 7,415 | 6,318 | 9.6% | 10.0% |
| Total other operating income | 16,629 | 14,312 | 13,014 | 14,268 | 13,346 | 10,381 | 16.2% | 9.9% |
| Other operating expenses | 30,521 | 29,523 | 27,315 | 25,482 | 25,020 | 25,405 | 3.4% | 3.7% |
| Income before income tax expense | 10,789 | 9,210 | 9,136 | 12,544 | 9,490 | 8,762 | 17.1% | 4.3% |
| Income tax expense | 3,530 | 2,621 | 2,546 | 3,811 | 2,537 | 2,222 | 34.7% | 9.7% |
| Net income | \$ 7,259 | \$ 6,589 | \$ 6,590 | \$ 8,733 | \$ 6,953 | \$ 6,540 | 10.2% | 2.1% |

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AVERAGE BALANCES AND YIELDS

For the purpose of the table below, non-accruing loans are included in the daily average loan amounts outstanding. Daily balances were used for average balance computations. Investment securities are stated at amortized cost. No tax equivalent adjustments have been made in calculating yields on obligations of states and political subdivisions.

Distribution of Assets, Liabilities and Shareholders' Equity, Interest Rates and Interest DifferentialYear Ended December 31,

| <u>Assets</u> | <u>2007</u> | | | <u>2006</u> | | | <u>2005</u> | | |
|------------------------------|------------------------|-----------------|--------------------|------------------------|-----------------|--------------------|------------------------|-----------------|--------------------|
| | <u>Average Balance</u> | <u>Interest</u> | <u>Yield/ Rate</u> | <u>Average Balance</u> | <u>Interest</u> | <u>Yield/ Rate</u> | <u>Average Balance</u> | <u>Interest</u> | <u>Yield/ Rate</u> |
| (Dollars in thousands) | | | | | | | | | |
| <u>Earning assets:</u> | | | | | | | | | |
| Loans | \$ 520,027 | \$36,019 | 6.93% | \$ 449,694 | \$30,312 | 6.74% | \$ 403,361 | \$25,189 | 6.24% |
| Taxable securities | 156,897 | 6,987 | 4.45 | 188,038 | 8,210 | 4.37 | 218,033 | 9,438 | 4.33 |
| Tax-exempt securities | 20,175 | 795 | 3.94 | 25,620 | 978 | 3.82 | 28,091 | 1,004 | 3.58 |
| Federal funds sold | 1,127 | 58 | 5.18 | 2,170 | 108 | 5.00 | 11,102 | 307 | 2.77 |
| Interest-bearing deposits | <u>324</u> | <u>16</u> | <u>4.84</u> | <u>350</u> | <u>17</u> | <u>4.73</u> | <u>716</u> | <u>21</u> | <u>2.93</u> |
| Total earning assets | <u>698,550</u> | <u>43,875</u> | <u>6.28%</u> | <u>665,872</u> | <u>39,625</u> | <u>5.95%</u> | <u>661,303</u> | <u>35,959</u> | <u>5.44%</u> |
| <u>Non-earning assets:</u> | | | | | | | | | |
| Cash and due from banks | 22,257 | | | 22,537 | | | 23,696 | | |
| Premises and equipment, net | 21,821 | | | 19,781 | | | 17,265 | | |
| Other assets | 26,546 | | | 20,121 | | | 17,024 | | |
| Allowance for loan losses | (8,155) | | | (9,503) | | | (10,203) | | |
| AFS adjustment to fair value | <u>6,016</u> | | | <u>3,219</u> | | | <u>6,259</u> | | |
| Total | \$ <u>767,035</u> | | | \$ <u>722,027</u> | | | \$ <u>715,344</u> | | |

Liabilities and
Shareholders' EquityInterest-bearing
liabilities:

| | | | | | | | | | |
|------------------------------------------------------------------------------------|----------------|---------------|--------------|----------------|---------------|--------------|----------------|---------------|--------------|
| Now and super now deposits | \$ 37,551 | 137 | 0.36% | \$ 38,249 | 177 | 0.46% | \$ 43,301 | 174 | 0.40% |
| Savings and insured money market deposits | 164,288 | 2,932 | 1.78 | 165,258 | 2,603 | 1.57 | 166,814 | 1,648 | 0.99 |
| Time deposits | 244,343 | 10,851 | 4.44 | 225,165 | 9,266 | 4.12 | 187,316 | 5,597 | 2.99 |
| Federal Home Loan Bank advances and securities sold under agreements to repurchase | <u>81,566</u> | <u>4,019</u> | <u>4.93%</u> | <u>63,250</u> | <u>3,033</u> | <u>4.80%</u> | <u>95,909</u> | <u>3,803</u> | <u>3.96%</u> |
| Total interest-bearing liabilities | <u>527,748</u> | <u>17,939</u> | <u>3.40%</u> | <u>491,922</u> | <u>15,079</u> | <u>3.07%</u> | <u>493,340</u> | <u>11,222</u> | <u>2.27%</u> |

Non-interest-bearing
liabilities:

| | | | | | | | | | |
|----------------------|-------------------|--|--|-------------------|--|--|-------------------|--|--|
| Demand deposits | 146,379 | | | 139,626 | | | 132,618 | | |
| Other liabilities | <u>8,332</u> | | | <u>9,259</u> | | | <u>7,866</u> | | |
| Total liabilities | 682,459 | | | 640,807 | | | 633,824 | | |
| Shareholders' equity | <u>84,576</u> | | | <u>81,220</u> | | | <u>81,520</u> | | |
| Total | \$ <u>767,035</u> | | | \$ <u>722,027</u> | | | \$ <u>715,344</u> | | |

| | | | | | | | | | |
|---------------------|-----------------|--|--|-----------------|--|--|-----------------|--|--|
| Net interest income | <u>\$25,936</u> | | | <u>\$24,546</u> | | | <u>\$24,737</u> | | |
|---------------------|-----------------|--|--|-----------------|--|--|-----------------|--|--|

Net interest rate spread 2.88% 2.88% 3.17%

Net interest margin 3.71% 3.69% 3.74%

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CHANGES DUE TO VOLUME AND RATE

The following table demonstrates the impact on net interest income of the changes in the volume of earning assets and interest-bearing liabilities and changes in rates earned and paid by the Corporation. For purposes of constructing this table, average investment securities are at average amortized cost and earning asset averages include non-performing loans. Therefore, the impact of changing levels of non-performing loans is reflected in the change due to rate, but does not affect changes due to volume. No tax equivalent adjustments were made.

| | 2007 vs. 2006 | | | 2006 vs. 2005 | | |
|----------------------------------|---------------------|---------|--------|---------------------|---------|--------|
| | Increase/(Decrease) | | | Increase/(Decrease) | | |
| | Total | Due to | Due to | Total | Due to | Due to |
| Interest income (in thousands) | Change | Volume | Rate | Change | Volume | Rate |
| Loans | \$5,707 | 4,852 | 855 | \$ 5,123 | 3,029 | 2,094 |
| Taxable investment securities | (1,223) | (1,384) | 161 | (1,228) | (1,308) | 80 |
| Tax-exempt investment securities | (183) | (213) | 30 | (26) | (91) | 65 |
| Federal funds sold | (50) | (54) | 4 | (199) | (347) | 148 |
| Interest-bearing deposits | (1) | (1) | - | (4) | (13) | 9 |
| Total interest income | \$4,250 | 1,995 | 2,255 | \$ 3,666 | 250 | 3,416 |
| Interest expense (in thousands) | | | | | | |
| Interest-bearing demand deposits | (40) | (3) | (37) | \$ 3 | (22) | 25 |
| Savings and insured money market | 329 | (15) | 344 | 955 | (16) | 971 |

| | | | | | | |
|------------------------------------------------------------------------------------|---------|-------|-------|----------|---------|-------|
| deposits | | | | | | |
| Time deposits | 1,585 | 821 | 764 | 3,669 | 1,280 | 2,389 |
| Federal Home Loan Bank advances and securities sold under agreements to repurchase | 986 | 901 | 85 | (770) | (1,464) | 694 |
| Total interest expense | \$2,860 | 1,146 | 1,714 | \$ 3,857 | (32) | 3,889 |
| | | | | | | |
| Net interest income | \$1,390 | 849 | 541 | \$ (191) | 282 | (473) |

Interest Rate Risk

As intermediaries between borrowers and savers, commercial banks incur both interest rate risk and liquidity risk. The Corporation's Asset/Liability Committee (ALCO) has the strategic responsibility for setting the policy guidelines on acceptable exposure to these areas. These guidelines contain specific measures and limits regarding these risks, which are monitored on a regular basis. The ALCO is made up of the, president & chief executive officer, two executive vice presidents, chief financial officer, asset liability management officer, senior marketing officer, and others representing key functions.

The ALCO is also responsible for supervising the preparation and annual revisions of the financial segments of the annual budget, which is built upon the committee's economic and interest-rate assumptions. It is the responsibility of the ALCO to modify prudently the Corporation's asset/liability policies.

Interest rate risk is the risk that net interest income will fluctuate as a result of a change in interest rates. It is the assumption of interest rate risk, along with credit risk, that drives the net interest margin of a financial institution. For that reason, the ALCO has established tolerance limits based upon a 200-basis point change in interest rates. At December 31, 2007, it is estimated that an immediate 200-basis point decrease in interest rates would negatively impact the next 12 months net interest income by 0.86% and an immediate 200-basis point increase would negatively impact the next 12 months net interest income by 5.30%. Both are within the Corporation's policy guideline of 15% established by ALCO.

A related component of interest rate risk is the expectation that the market value of our capital account will fluctuate with changes in interest rates. This component is a direct corollary to the earnings-impact component: an institution exposed to earnings erosion is also exposed to shrinkage in market value. At December 31, 2007, it is estimated that an immediate 200-basis point decrease in interest rates would negatively impact the market value of our capital account by 6.93% and an immediate 200-basis point increase in interest rates would negatively impact the market value by 5.18%. Both are within the established tolerance limit of 15%.

Management does recognize the need for certain hedging strategies during periods of anticipated higher fluctuations in interest rates and the Board-approved Funds Management Policy provides for limited use of certain derivatives in asset liability management. These strategies were not employed during 2007.

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RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") released Financial Interpretation No. 48 ("FIN 48"). FIN 48 became effective for fiscal years beginning after December 15, 2006. FIN 48 clarified the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109 (FASB 109"). This Interpretation prescribes a recognition threshold and a measurement attribute to determine whether a tax position will ultimately be sustained. The Corporation adopted FIN 48, as of January 1, 2007. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The adoption had no effect on the Corporation's financial statements.

The Corporation is no longer subject to examination by U.S. Federal income taxing authorities for years before 2003, or by New York State taxing authorities for years before 2004. We have no unrecognized tax benefits and do not anticipate any increase in unrecognized benefits over the next 12 months relative to any tax positions taken prior to January 1, 2007.

The Corporation recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other expense. The Corporation did not have any amounts accrued for interest or penalties at January 1, 2007.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159, "The Fair Value Option of Financial Assets and Financial Liabilities" ("FAS 159"). The fair value option, established by this Statement permits entities to choose to measure eligible items at fair value at specified election dates. The Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted under certain conditions. The Corporation is evaluating the potential effect FAS 159 may have on the Corporation's financial statements at this time.

In September 2006, FASB issued Statement No. 157, Fair Value Measurements ("FAS 157"). FAS 157 defines fair value, establishes a framework for measuring fair value and expands disclosures about fair value measurements. This statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, which delays the effective date of FAS 157 to fiscal years beginning after November 15, 2008. The Corporation is evaluating the potential effect FAS 157 may have on the Corporation's financial statements at this time.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Corporation's main market risk exposure is to changing interest rates. A discussion of the Corporation's exposure to changing interest rates is included under the heading "Interest Rate Risk" in Management's Discussion and Analysis of Financial Condition and Results of Operations.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

The financial statements listed in Item 15 are filed as part of this report and appear on pages F-1 through F-29.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

Item 9A. CONTROLS AND PROCEDURES

The Corporation's management, with the participation of our President and Chief Executive Officer, who is the Corporation's principal executive officer, and our Treasurer and Chief Financial Officer, who is the Corporation's principal financial officer, has evaluated the effectiveness of the Corporation's disclosure controls and procedures as of December 31, 2007. Based upon that evaluation, the President and Chief Executive Officer and the Treasurer and Chief Financial Officer have concluded that the Corporation's disclosure controls and procedures are effective as of December 31, 2007.

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During the fourth fiscal quarter, there have been no changes in the Corporation's internal control over financial reporting that have materially affected, or that are reasonably likely to materially affect, the Corporation's internal control over financial reporting.

Management's Report on Internal Control over Financial Reporting

We, as members of management of the Corporation, are responsible for establishing and maintaining adequate internal control over financial reporting. The Corporation's internal control over financial reporting is a process designed to provide reasonable assurance to the Corporation's management and Board of Directors regarding the reliability of financial reporting and the preparation of the Corporation's financial statements for external purposes in accordance with general accepted accounting principles. Internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the Corporation, (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Corporation are being made only in accordance with

authorizations of management and directors of the Corporation, and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Corporation's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies and procedures may deteriorate.

As of December 31, 2007 management assessed the effectiveness of the Corporation's internal control over financial reporting based on the criteria for effective internal control over financial reporting established in the "Internal Control-Integrated Framework," issued by the Committee of Sponsoring Organizations (COSO) of the Treadway Commission. Based on the assessment, we assert that the Corporation maintained effective internal control over financial reporting as of December 31, 2007 based on the specified criteria.

Crowe Chizek and Company LLC, an independent registered public accounting firm, which audited the Corporation's 2007 financial statements included in this report, has issued an audit report on the effective operation of the Corporation's internal controls over financial reporting.

/s/ Ronald M. Bentley

President and Chief Executive Officer

March 10, 2008

/s/ John R. Battersby, Jr.

Treasurer and Chief Financial Officer

March 10, 2008

Item 9B. OTHER INFORMATION

None

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PART III

ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE

The names and ages of the executive officers of the Corporation and positions held by each are presented in the following table. Officers are elected annually by the Board of Directors.

| Name | Age | Position (served since) |
|------------------------|-----|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| Ronald M. Bentley | 55 | President and Chief Executive Officer of the Corporation and the Bank (2007); formerly President and Chief Operating Officer of the Bank; formerly President Retail Banking, NBT Bank (2005-2006); Executive Vice President, Retail Banking and Regional President, NBT Bank (2003-2005). Mr. Bentley has been with the Company since 2006. |
| John R. Battersby, Jr. | 57 | Chief Financial Officer and Treasurer of the Corporation (2003); Executive Vice President, Chief Financial Officer and Treasurer (2004). Mr. Battersby has been with the Company since 1988. |
| Richard G. Carr | 54 | Senior Vice President of the Bank (2004); formerly Vice President Commercial Loans (1997). Mr. Carr has been with the Company since 1997. |
| Michael J. Crimmins | 55 | Senior Vice President of the Bank, (2006). Mr. Crimmins was formerly with Elmira Savings & Loan Association, F.A. |
| James E. Corey III | 61 | Executive Vice President of the Corporation (1998) and Vice President of the Bank (1993). Mr. Corey has been with the Company since 1988. |
| Louis C. DiFabio | 44 | Senior Vice President of the Bank (2005); formerly Vice President of the Bank (2002). Mr. DiFabio has been with the Company since 1987. |
| Melinda A. Sartori | 50 | Executive Vice President of the Bank (2002); formerly Senior Vice President of the Bank (1999). Mr. Sartori has been with the Company since 1994. |
| Linda M. Struble | 54 | Senior Vice President (2000); formerly Vice President of the Bank (1997). Ms. Struble has been with the Company since 1984. |
| Norman R. Ward | 58 | Senior Vice President and Chief Auditor of the Corporation and Bank (2000). Mr. Ward has been with the Company since 1971. |
| Michael J. Wayne | 47 | Vice President of the Bank (2006); Mr. Wayne was formerly with Elmira Savings & Loan Association, F.A. |

Additional information responsive to this Item 10 is incorporated herein by reference to the Corporation's definitive proxy statement for its 2008 annual meeting of shareholders.

ITEM 11. EXECUTIVE COMPENSATION

Information responsive to this Item 11 is incorporated herein by reference to the Corporation's definitive proxy statement for its 2008 annual meeting of shareholders.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND, MANAGEMENT AND RELATED STOCKHOLDER MATTERS

Information responsive to this Item 12 is incorporated herein by reference to the Corporation's definitive proxy statement for its 2008 annual meeting of shareholders.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, DIRECTOR INDEPENDENCE

Information responsive to this Item 13 is incorporated herein by reference to the Corporation's definitive proxy statement for its 2008 annual meeting of shareholders.

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ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES

Information responsive to this Item 14 is incorporated herein by reference to the Corporation's definitive proxy statement for its 2008 annual meeting of shareholders.

PART IV

ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES

(a) (1)

The following consolidated financial statements of the Corporation appear on pages F-1 through F-30 of this report and are incorporated in Part II, Item 8:

Report of Independent Registered Public Accounting Firm-Crowe Chizek and Company LLC

Report of Independent Registered Public Accounting Firm-KPMG LLP

Consolidated Financial Statements

Consolidated Balance Sheets as of December 31, 2007 and 2006

Consolidated Statements of Income for the three years ended December 31, 2007

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Consolidated Statements of Shareholders' Equity and Comprehensive Income for the three years ended December 31, 2007

Consolidated Statements of Cash Flows for the three years ended December 31, 2007

Notes to Consolidated Financial Statements

(2) All schedules for which provision is made in the applicable accounting regulations of the Securities & Exchange Commission are not required under the related instructions or are inapplicable and therefore have been omitted.

b. The following exhibits are either filed with this Form 10-K or are incorporated herein by reference. The Corporation's Securities Exchange Act file number is 000-13888.

Exhibit 2.1 Merger Agreement dated October 12, 2006 between Chemung Canal Trust Company and Partners Trust Financial Group, Inc. entered into as a Trust Company Agreement and Plan of Merger. Filed as Exhibit 2.1 to Registrant's Form 8-K filed with the SEC on October 12, 2006 and incorporated herein by reference.

3.1 Certificate of Incorporation of Chemung Financial Corporation dated December 20, 1984.

3.2 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated March 28, 1988.

3.3 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated May 13, 1998. Filed as Exhibit 3.4 of the Registrant's Form 10-K for the year ended December 31, 2005 and incorporated herein by reference.

3.4 Amended and Restated Bylaws of the Registrant, as amended to November 21, 2007. Filed as Exhibit 3.1 to Registrant's Form 8-K filed with the SEC on November 21, 2007 incorporated by reference herein.

4.1 Specimen Stock Certificate. Filed as Exhibit 4.1 to Registrant's Form 10-K for the year ended December 31, 2002 and incorporated by reference herein.

10.1 Change of Control Agreement dated September 20, 2006 between Chemung Canal Trust Company and Ronald M. Bentley, President & COO. Filed as Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended September 30, 2006 and incorporated by reference herein.

10.2 Executive Severance Agreement dated September 20, 2006 between Chemung Canal Trust Company and Ronald M. Bentley, President & COO. Filed as Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended September 30, 2006 and incorporated by reference herein.

10.3 Amended and Restated Deferred Directors' Fee Plan. Filed as Exhibit 10.3 of the Registrant's Form 10-K for the year ended December 31, 2005 and incorporated by reference herein.

10.4 Employment Agreement dated as of November 8, 2001 between Chemung Canal Trust Company and Jan P. Updegraff, President and Chief Executive Officer. Filed as Exhibit

10.4 to Registrants' Form 10-K for the year ended December 31, 2002 and incorporated by reference herein.

- 10.5 Employment Contract Addendum dated as of November 30, 2006 between Chemung Canal Trust Company and Jan P. Updegraff, Vice Chairman and Chief Executive Officer. Filed as Exhibit 10.5 to Registrants' Form 10-K for the year ended December 31, 2006 and incorporated by reference herein.

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- 10.6 Description of Arrangement for Directors' Fees. Filed as Exhibit 10.6 of the Registrant's Form 10-K for the year ended December 31, 2005 and incorporated by reference herein.
- 10.7 Employment Contract Addendum dated as of November 21, 2007 between Chemung Canal Trust Company and Jan P. Updegraff, Vice Chairman.
- 10.8 Change of Control Agreement dated August 23, 2007 Chemung Canal Trust Company and John R. Battersby, Jr., Executive Vice President, Treasurer & CFO.
- 10.9 Change of Control Agreement dated August 23, 2007 between Chemung Canal Trust Company and Melinda A. Sartori, Executive Vice President
- 10.10 Change of Control Agreement dated August 23, 2007 between Chemung Canal Trust Company and James E. Corey, III, Executive Vice President
- 10.11 Purchase Agreement dated November 30, 2007 between Chemung Canal Trust Company and Manufacturers and Traders Trust Company. Filed as Exhibit 2.1 to Registrant's Form 8-K filed with the SEC on December 4, 2007 and incorporated herein by reference.

21 Subsidiaries of the Registrant.

- 23.1 Consent of Crowe Chizek and Company LLC, Independent Registered Public Accounting Firm.
- 23.2 Consent of KPMG LLP, Independent Registered Public Accounting Firm.
- 31.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
- 31.2 Certification of Treasurer and Chief Financial Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.
- 32.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 19 U.S.C. 1350.
- 32.2 Certification of Treasurer and Chief Financial Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 19 U.S.C. 1350.

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CHEMUNG FINANCIAL CORPORATION

INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

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| Report of Independent Registered Public Accounting Firm-Crowe Chizek and Company LLC | F-1 |
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| Consolidated Financial Statements | |
| Consolidated Balance Sheets as of December 31, 2007 and 2006 | F-4 |
| Consolidated Statements of Income for the three years ended December 31, 2007 | F-5 |
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Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders

Chemung Financial Corporation

Elmira, New York

We have audited the accompanying consolidated balance sheets of Chemung Financial Corporation as of December 31, 2007 and 2006, and the related consolidated statements of income, shareholders' equity and comprehensive income, and cash flows for the years ended December 31, 2007 and 2006. We also have audited Chemung Financial Corporation's internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO)*. Chemung Financial Corporation's management is responsible for these financial statements, for maintaining effective internal control over financial reporting, and for its assessment of the effectiveness of internal control over financial reporting, included in Management's Report on Internal Control Over Financial Reporting. Our responsibility is to express an opinion on these financial statements and an opinion on the corporation's internal control over financial reporting based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements include examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal controls based on the assessed risk. Our audits also include performing such other procedures

as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

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In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Chemung Financial Corporation as of December 31, 2007 and 2006, and the results of its operations and its cash flows for the years ended December 31, 2007 and 2006 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, Chemung Financial Corporation maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

/s/ Crowe Chizek and Company LLC

Livingston, New Jersey

March 10, 2008

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Shareholders
Chemung Financial Corporation:

We have audited the accompanying consolidated statements of income, shareholders' equity and comprehensive income, and cash flows of Chemung Financial Corporation and subsidiaries (the "Company") for the year ended December 31, 2005. 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 audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). 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 significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of Chemung Financial Corporation and subsidiaries for the year ended December 31, 2005, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

Albany, New York

March 3, 2006

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CONSOLIDATED FINANCIAL STATEMENTS

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

DECEMBER 31,

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| <u>ASSETS</u> | <u>2007</u> | <u>2006</u> |
|-----------------------------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
| Cash and due from financial institutions | \$ 29,095,659 | \$ 26,343,804 |
| Interest-bearing deposits in other financial institutions | <u>282,676</u> | <u>246,470</u> |
| Total cash and cash equivalents | <u>29,378,335</u> | <u>26,590,274</u> |
| Securities available for sale, at estimated fair value | 165,321,115 | 184,829,551 |
| Securities held to maturity, estimated fair value of \$4,575,465 at December 31, 2007, and \$6,876,509 at December 31, 2006 | 4,479,815 | 6,866,209 |
| Federal Home Loan Bank and Federal Reserve Bank Stock, at cost | 5,901,550 | 3,604,750 |
| Loans, net of deferred origination fees and costs, and unearned income | 539,522,490 | 477,663,879 |
| Allowance for loan losses | <u>(8,452,819)</u> | <u>(7,983,256)</u> |
| Loans, net | <u>531,069,671</u> | <u>469,680,623</u> |
| Loans held for sale | 39,400 | - |
| Premises and equipment, net | 23,220,106 | 21,722,094 |
| Goodwill | 1,516,666 | 1,516,666 |
| Other intangible assets, net | 5,629,776 | 961,156 |
| Other assets | <u>22,317,085</u> | <u>23,278,209</u> |
| Total assets | <u>\$788,873,519</u> | <u>\$739,049,532</u> |

LIABILITIES AND SHAREHOLDERS' EQUITY

Deposits:

| | | |
|------------------------------------------------|--------------------|--------------------|
| Non-interest-bearing | \$145,491,880 | \$151,600,733 |
| Interest-bearing | <u>427,108,049</u> | <u>433,491,144</u> |
| Total deposits | 572,599,929 | 585,091,877 |
| Securities sold under agreements to repurchase | 31,212,292 | 35,023,948 |
| Federal Home Loan Bank term advances | 20,000,000 | 20,000,000 |
| Federal Home Loan Bank overnight advances | 62,400,000 | 7,900,000 |
| Accrued interest payable | 1,292,442 | 1,323,296 |
| Dividends payable | 879,682 | 848,989 |
| Other liabilities | <u>12,374,224</u> | <u>6,563,161</u> |

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| | | |
|------------------------------------------------------------------------------------------------------------------------------|----------------------|----------------------|
| Total liabilities | <u>700,758,569</u> | <u>656,751,271</u> |
| Commitments and contingencies (note 15) | | |
| Shareholders' equity: | | |
| Common stock, \$.01 par value per share, 10,000,000 shares authorized; 4,300,134 shares issued at December 31, 2007 and 2006 | 43,001 | 43,001 |
| Additional paid-in capital | 22,801,241 | 22,652,405 |
| Retained earnings | 81,029,531 | 77,183,407 |
| Treasury stock, at cost (781,481 shares at December 31, 2007; 764,420 shares at December 31, 2006) | (20,138,214) | (19,496,106) |
| Accumulated other comprehensive income | <u>4,379,391</u> | <u>1,915,554</u> |
| Total shareholders' equity | <u>88,114,950</u> | <u>82,298,261</u> |
| Total liabilities and shareholders' equity | <u>\$788,873,519</u> | <u>\$739,049,532</u> |

See accompanying notes to consolidated financial statements.

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CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME

YEARS ENDED DECEMBER 31

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|------------------------------------------------|-------------------|-------------------|-------------------|
| Interest and dividend income: | | | |
| Loans, including fees | \$36,019,386 | 30,311,710 | 25,188,575 |
| Taxable securities | 6,987,265 | 8,209,994 | 9,438,529 |
| Tax exempt securities | 794,630 | 977,913 | 1,004,524 |
| Federal funds sold | 58,350 | 108,403 | 306,809 |
| Interest-bearing deposits | <u>15,703</u> | <u>16,497</u> | <u>20,945</u> |
| Total interest and dividend income | <u>43,875,334</u> | <u>39,624,517</u> | <u>35,959,382</u> |
| Interest expense: | | | |
| Deposits | 13,920,124 | 12,045,133 | 7,419,238 |
| Borrowed funds | 2,175,744 | 1,003,001 | 1,163,813 |
| Securities sold under agreements to repurchase | <u>1,843,131</u> | <u>2,030,413</u> | <u>2,638,918</u> |
| Total interest expense | <u>17,938,999</u> | <u>15,078,547</u> | <u>11,221,969</u> |

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| | | | |
|-----------------------------------------------------|---------------------|-------------------|-------------------|
| Net interest income | 25,936,335 | 24,545,970 | 24,737,413 |
| Provision for loan losses | <u>1,255,000</u> | <u>125,000</u> | <u>1,300,000</u> |
| Net interest income after provision for loan losses | <u>24,681,335</u> | <u>24,420,970</u> | <u>23,437,413</u> |
| Other operating income: | | | |
| Trust & investment services income | 6,345,041 | 4,900,833 | 5,094,625 |
| Service charges on deposit accounts | 4,706,049 | 4,399,611 | 3,834,057 |
| Net gain on securities transactions | 9,680 | 26,570 | 6,000 |
| Net gain on sales of loans held for sale | 97,595 | 103,425 | 106,771 |
| Credit card merchant earnings | 1,636,787 | 1,523,250 | 1,479,955 |
| Gains on sales of other real estate | 671,923 | 3,800 | 19,730 |
| Other | <u>3,161,439</u> | <u>3,354,605</u> | <u>2,472,645</u> |
| Total other operating income | <u>16,628,514</u> | <u>14,312,094</u> | <u>13,013,783</u> |
| Other operating expenses: | | | |
| Salaries and wages | 12,609,190 | 10,823,084 | 10,326,758 |
| Pension and other employee benefits | 2,030,036 | 2,698,211 | 2,924,469 |
| Net occupancy expenses | 3,248,482 | 2,973,000 | 2,595,160 |
| Furniture and equipment expenses | 1,983,011 | 2,041,548 | 1,974,876 |
| Amortization of intangible assets | 633,363 | 397,719 | 397,719 |
| Data processing expense | 3,802,642 | 3,969,789 | 3,330,209 |
| Other | <u>6,213,630</u> | <u>6,619,868</u> | <u>5,766,376</u> |
| Total other operating expenses | <u>30,520,354</u> | <u>29,523,219</u> | <u>27,315,567</u> |
| Income before income tax expense | 10,789,495 | 9,209,845 | 9,135,629 |
| Income tax expense | <u>3,530,112</u> | <u>2,621,279</u> | <u>2,546,088</u> |
| Net income | <u>\$ 7,259,383</u> | <u>6,588,566</u> | <u>6,589,541</u> |
| Weighted average shares outstanding | <u>3,594,998</u> | <u>3,642,370</u> | <u>3,688,837</u> |
| Basic and diluted earnings per share | <u>\$2.02</u> | <u>\$1.81</u> | <u>\$1.79</u> |

See accompanying notes to consolidated financial statements.

CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

| | <u>Common Stock</u> | Additional paid-in <u>Capital</u> | <u>Retained Earnings</u> | <u>Treasury Stock</u> | Accumulated Other Comprehensive <u>Income</u> | <u>Total</u> |
|------------------------------------------------------------------------------------------------|-------------------------|-----------------------------------------|------------------------------|---------------------------|--------------------------------------------------------|--------------------|
| Balances at December 31, 2004 | \$ 43,001 | \$22,657,816 | \$70,050,443 | \$(15,520,347) | \$ 4,965,559 | \$82,196,472 |
| Comprehensive Income: | | | | | | |
| Net income | - | - | 6,589,541 | - | - | 6,589,541 |
| Change in unrealized gain on securities AFS, net | - | - | - | - | (2,302,373) | <u>(2,302,373)</u> |
| Total comprehensive income | | | | | | 4,287,168 |
| Restricted stock units for directors' deferred compensation plan | - | 160,252 | - | - | - | 160,252 |
| Directors' compensation stock grants | - | 240,898 | - | - | - | 240,898 |
| Distribution of 13,245 shares restricted stock units for directors' deferred compensation plan | - | (271,379) | - | 323,752 | - | 52,373 |
| Cash dividends declared (\$.96 per share) | - | - | (3,471,081) | - | - | (3,471,081) |
| Purchase of 71,065 shares of treasury stock | = | = | = | <u>(2,288,085)</u> | = | <u>(2,288,085)</u> |
| Balances at December 31, 2005 | <u>\$ 43,001</u> | <u>22,287,587</u> | <u>73,168,903</u> | <u>(17,484,680)</u> | <u>2,663,186</u> | <u>81,177,997</u> |
| Impact from adopting SEC Staff Accounting Bulletin 108 (SAB 108) | - | - | 847,962 | - | - | 847,962 |

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Comprehensive
Income:

| | | | | | | |
|-----------------------------------------------------------------------------------------------------------|------------------|-------------------|-------------------|---------------------|------------------|--------------------|
| Net income | - | - | 6,588,566 | - | - | 6,588,566 |
| Change in unrealized gain on securities AFS, net | - | - | - | - | 262,925 | <u>262,925</u> |
| Total comprehensive income | | | | | | 6,851,491 |
| Adjustment to initially apply SFAS No. 158 net(note 11) | - | - | - | - | (1,010,557) | (1,010,557) |
| Restricted stock units for directors' deferred compensation plan | - | 82,241 | - | - | - | 82,241 |
| Distribution of 7,963 shares of treasury stock for directors' compensation plan | - | (198,597) | - | 198,597 | - | - |
| Distribution of 1,193 shares restricted stock units for directors' deferred compensation plan | - | (26,436) | - | 29,897 | - | 3,461 |
| Distribution of 1,000 shares of treasury stock for employee compensation | - | 7,610 | - | 25,390 | - | 33,000 |
| Cash dividends declared (\$.96 per share) | - | - | (3,422,024) | - | - | (3,422,024) |
| Purchase of 73,496 shares of treasury stock | = | = | = | <u>(2,265,310)</u> | = | <u>(2,265,310)</u> |
| Balances at December 31, 2006 | <u>\$ 43,001</u> | <u>22,652,405</u> | <u>77,183,407</u> | <u>(19,496,106)</u> | <u>1,915,554</u> | <u>82,298,261</u> |

Comprehensive
Income:

| | | | | | | |
|--------------------------------------------------------|---|---|-----------|---|-----------|-----------|
| Net income | - | - | 7,259,383 | - | - | 7,259,383 |
| Change in unrealized gain on securities AFS, net | - | - | - | - | 1,986,127 | 1,986,127 |

| | | | | | | |
|-----------------------------------------------------------------------------------------------|------------------|---------------------|---------------------|-----------------------|---------------------|---------------------|
| Change in funded status of Employers' Accounting for | - | - | - | - | 477,710 | <u>477,710</u> |
| Defined Benefit Pension and Other Benefit Plans, net | | | | | | |
| Total comprehensive income | | | | | | 9,723,220 |
| Restricted stock units for directors' deferred compensation plan | - | 84,867 | - | - | - | 84,867 |
| Distribution of 7,334 shares of treasury stock for directors' compensation plan | - | 54,265 | - | 187,017 | - | 241,282 |
| Distribution of 1,230 shares restricted stock units for directors' deferred compensation plan | - | (27,659) | - | 31,476 | - | 3,817 |
| Distribution of 1,000 shares of treasury stock for employee compensation | - | 3,250 | - | 25,750 | - | 29,000 |
| Cash dividends declared (\$.97 per share) | - | - | (3,413,259) | - | - | (3,413,259) |
| Sale of 13,700 shares of treasury stock | - | 34,113 | | 352,911 | | 387,024 |
| Purchase of 40,325 shares of treasury stock | = | = | = | <u>(1,239,262)</u> | = | <u>(1,239,262)</u> |
| Balances at December 31, 2007 | <u>\$ 43,001</u> | <u>\$22,801,241</u> | <u>\$81,029,531</u> | <u>\$(20,138,214)</u> | <u>\$ 4,379,391</u> | <u>\$88,114,950</u> |

See accompanying notes to consolidated financial statements.

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YEARS ENDED DECEMBER 31

2007 2006 2005

Cash flows from operating activities:

| | | | |
|-------------------------------------------------------------------------------------|-------------------|-------------------|-------------------|
| Net income | \$ 7,259,383 | \$ 6,588,566 | \$ 6,589,541 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Amortization of intangible assets | 633,363 | 397,719 | 397,719 |
| Deferred income tax expense | 471,138 | 3,980,216 | 391,994 |
| Provision for loan losses | 1,255,000 | 125,000 | 1,300,000 |
| Depreciation and amortization of fixed assets | 2,618,987 | 2,604,689 | 2,414,031 |
| Amortization of premiums on securities, net | 45,370 | 111,340 | 221,635 |
| Accretion of deferred gain on sale of credit cards | (86,188) | (103,425) | (103,425) |
| Gain on sales of loans held for sale, net | (11,407) | - | (3,346) |
| Proceeds from sales of loans held for sale | 503,857 | - | 207,746 |
| Loans originated and held for sale | (492,450) | - | (204,400) |
| Net gain on sale of other real estate owned | (649,065) | (3,800) | (6,307) |
| Net gain on securities transactions | (9,680) | (26,570) | (6,000) |
| (Increase) decrease in other assets | (783,637) | 3,309,496 | 792,770 |
| Increase (decrease) in accrued interest payable | (30,854) | 263,403 | (34,016) |
| Expense related to employee stock compensation | 29,000 | 33,000 | - |
| Expense related to restricted stock units for directors' deferred compensation plan | 84,867 | 82,241 | 160,252 |
| Directors' compensation stock grants | - | - | 240,898 |
| (Decrease) increase in other liabilities | 4,916,415 | (6,088,659) | 2,693,505 |
| Origination of student loans | (5,733,707) | (5,544,071) | (5,190,206) |
| Proceeds from sales of student loans | <u>5,218,044</u> | <u>4,547,836</u> | <u>4,614,993</u> |
| Net cash provided by operating activities | <u>15,238,436</u> | <u>10,276,981</u> | <u>14,477,384</u> |

Cash flows from investing activities:

| | | | |
|------------------------------------------------------|---|---|-------|
| Proceeds from sales of securities available for sale | - | - | 6,774 |
|------------------------------------------------------|---|---|-------|

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| | | | |
|--------------------------------------------------------------------------------------|---------------------|---------------------|---------------------|
| Proceeds from maturities of and principal collected on securities available for sale | 32,791,379 | 48,495,448 | 63,289,208 |
| Proceeds from maturities of and principal collected on securities held to maturity | 4,122,044 | 5,442,336 | 11,499,851 |
| Purchases of securities available for sale | (10,100,000) | - | (57,120,890) |
| Purchases of securities held to maturity | (1,735,650) | (3,722,326) | (7,702,497) |
| Purchase of Federal Home Loan Bank and Federal Reserve Bank stock | (25,179,300) | (17,168,050) | (7,157,750) |
| Redemption of Federal Home Loan Bank and Federal Reserve Bank stock | 22,882,500 | 18,919,650 | 7,745,800 |
| Cash paid for purchase of trust business | (5,301,983) | - | - |
| Proceeds from sale of other real estate owned | 2,421,026 | 29,842 | 187,998 |
| Pension Contribution | - | (10,000,000) | (1,323,439) |
| Purchases of premises and equipment | (4,116,999) | (5,618,797) | (3,908,851) |
| Net increase in loans | <u>(62,194,985)</u> | <u>(61,343,812)</u> | <u>(34,994,144)</u> |
| Net cash used by investing activities | <u>(46,411,968)</u> | <u>(24,965,709)</u> | <u>(29,477,940)</u> |

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CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
Consolidated Statements of Cash Flows (con't)

Cash flows from financing activities:

| | | | |
|--------------------------------------------------------------------------------------------------------------|--------------|--------------|--------------|
| Net (decrease)increase in demand deposits, NOW accounts, savings accounts, and insured money market accounts | (9,050,100) | 16,261,222 | 4,066,336 |
| Net (decrease) increase in time deposits and individual retirement accounts | (3,441,848) | 43,893,577 | 1,311,144 |
| Net (decrease) increase in securities sold under agreements to repurchase | (3,811,656) | (25,831,717) | (27,648,855) |
| Proceeds from Federal Home Loan Bank term advances | 10,000,000 | 10,000,000 | - |
| Proceeds from Federal Home Loan Bank overnight advances | 62,400,000 | 7,900,000 | 20,800,000 |
| Repayments of Federal Home Loan Bank overnight advances | (7,900,000) | (20,800,000) | - |
| Repayment of Federal Home Loan Bank term advances | (10,000,000) | (10,000,000) | (5,000,000) |

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| | | | |
|------------------------------------------------------|---------------------|---------------------|---------------------|
| Purchase of treasury stock | (1,239,262) | (2,265,310) | (2,288,085) |
| Sale of treasury stock | 387,025 | - | - |
| Cash dividends paid | <u>(3,382,566)</u> | <u>(3,436,808)</u> | <u>(3,484,958)</u> |
| Net cash provided (used) by financing activities | <u>33,961,593</u> | <u>15,720,964</u> | <u>(12,244,418)</u> |
| Net increase (decrease) in cash and cash equivalents | 2,788,061 | 1,032,236 | (27,244,974) |
| Cash and cash equivalents, beginning of year | <u>26,590,274</u> | <u>25,558,038</u> | <u>52,803,012</u> |
| Cash and cash equivalents, end of year | <u>\$29,378,335</u> | <u>\$26,590,274</u> | <u>\$25,558,038</u> |
| Supplemental disclosure of cash flow information: | | | |
| Cash paid during the year for: | | | |
| Interest | <u>\$17,969,853</u> | <u>\$14,815,145</u> | <u>\$11,255,985</u> |
| Income taxes | <u>\$ 30,972</u> | <u>\$ 1,842,295</u> | <u>\$ 108,346</u> |
| Supplemental disclosure of non-cash activity: | | | |
| Transfer of loans to other real estate owned | <u>\$ 27,200</u> | <u>\$ 1,545,418</u> | <u>\$ 155,759</u> |

See accompanying notes to consolidated financial statements.

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CHEMUNG FINANCIAL CORPORATION AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
DECEMBER 31, 2007, 2006 and 2005

(1) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION

Chemung Financial Corporation (the "Corporation"), through its wholly owned subsidiaries, Chemung Canal Trust Company (the "Bank") and CFS Group, Inc., provides a wide range of banking, financing, fiduciary and other financial services to its clients. The Corporation is subject to the regulations of certain federal and state agencies and undergoes periodic examinations by those regulatory agencies.

BASIS OF PRESENTATION

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America and include the accounts of the Corporation and its subsidiaries. All significant intercompany balances and transactions are eliminated in consolidation.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

As permitted by Staff Accounting Bulletin No. 108 ("SAB 108"), the December 31, 2006 balance sheet has been corrected to reflect the accrual of trust fee income which had previously been recognized on the cash basis. These differences, which are deemed to be immaterial, were identified during the second quarter of 2007. Such adjustments resulted in increases in other assets, other liabilities and shareholders' equity in the amounts of \$880 thousand, \$343 thousand and \$537 thousand, respectively as of December 31, 2006.

SECURITIES

Management determines the appropriate classification of securities at the time of purchase. If management has the intent and the Corporation has the ability at the time of purchase to hold securities until maturity, they are classified as held to maturity and carried at amortized cost. Securities to be held for indefinite periods of time or not intended to be held to maturity are classified as available for sale and carried at fair value. Unrealized holding gains and losses on securities classified as available for sale are excluded from earnings and are reported as accumulated other comprehensive income (loss) in shareholders' equity, net of the related tax effects, until realized. Realized gains and losses are determined using the specific identification method.

A decline in the fair value of any available for sale or held to maturity security below amortized cost that is deemed other than temporary is charged to earnings resulting in the establishment of a new cost basis for the security. Securities are placed on non-accrual status when management believes there are significant doubts regarding the

ultimate collectibility of interest and/or principal. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment of yield using the interest method. Dividend and interest income is recognized when earned.

FEDERAL HOME LOAN BANK (FHLB) AND FEDERAL RESERVE BANK (FRB) STOCK:

The Bank is a member of both the FHLB and FRB system. FHLB members are required to own a certain amount of stock based on the level of borrowings and other factors, while FRB members are required to own a certain amount of stock based on a percentage of the Bank's capital stock and surplus. FHLB and FRB stock are carried at cost and classified as non-marketable equities. Cash dividends are reported as income.

LOANS

Loans are stated at the amount of unpaid principal balance less unearned discounts and net deferred origination fees and costs. The Corporation has the ability and intent to hold its loans for the foreseeable future, except for student loans, which are sold to a third party upon reaching repayment status.

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Certain mortgage loans are originated with the intent to sell. Loans held for sale are recorded at the lower of cost or fair value. Loans held for sale, as well as the commitments to sell the loans that are originated for sale, are regularly evaluated for changes in fair value. If necessary, a valuation allowance is established with a charge to income for unrealized losses attributable to a change in market rates.

Interest on loans is accrued and credited to operations using the interest method. The accrual of interest is generally discontinued and previously accrued interest is reversed when commercial loans become 90 days delinquent, and when consumer, mortgage and home equity loans, which are not guaranteed by government agencies, become 120 days delinquent. Loans may also be placed on non-accrual status if management believes such classification is otherwise warranted. Loans are returned to accrual status when they become current as to principal and interest or when, in the opinion of management, the Corporation expects to receive all of its original principal and interest. Loan origination fees and certain direct loan origination costs are deferred and amortized over the life of the loan as an adjustment to yield, using the interest method.

ALLOWANCE FOR LOAN LOSSES

The allowance for loan losses is increased through a provision for loan losses charged to operations. Loans are charged against the allowance for loan losses when management believes that the collectibility of all or a portion of the principal is unlikely. The allowance is an amount that management believes will be adequate to absorb probable losses on existing loans. Management's evaluation of the adequacy of the allowance for loan losses is performed on a periodic basis and takes into consideration such factors as the historical loan loss experience, review of specific problem loans (including evaluations of the underlying collateral), changes in the composition and volume of the loan portfolio, overall portfolio quality, and current economic conditions that may affect the borrowers' ability to pay. Management believes that the allowance for loan losses is adequate. While management uses available information to

recognize losses on loans, future additions to the allowance may be necessary based on changes in economic conditions. In addition, various regulatory agencies, as an integral part of their examination process, periodically review the Corporation's allowance for loan losses. Such agencies may require the Corporation to recognize additions to the allowance based on their judgments about information available to them at the time of their examination.

Management, after considering current information and events regarding the borrower's ability to repay their obligations, classifies a loan as impaired when it is probable that the Corporation will be unable to collect all amounts due according to the contractual terms of the loan agreement. When a loan is considered to be impaired, the amount of the impairment is measured based on the present value of expected future cash flows discounted at the loan's effective interest rate or, as a practical expedient, at the loan's observable market price or the fair value of collateral, less the estimated costs to sell, if the loan is collateral dependent. Commercial and commercial real estate loans that are in non-accrual or troubled debt restructuring status, as well as accruing loans 90 days or more past due are considered to be impaired loans. Residential mortgage loans and consumer loans are evaluated collectively since they are homogeneous and generally carry smaller balances. In general, interest income on impaired loans is recorded on a cash basis when collection in full is reasonably expected. If full collection is uncertain, cash receipts are applied first to principal, then to interest income.

PREMISES AND EQUIPMENT

Land is carried at cost, while buildings, equipment, leasehold improvements and furniture are stated at cost less accumulated depreciation and amortization. Depreciation is charged to current operations under the straight-line method over the

estimated useful lives of the assets, which range from 15 to 50 years for buildings and from 3 to 10 years for equipment and furniture. Amortization of leasehold improvements and leased equipment is recognized on the straight-line method over the shorter of the lease term or the estimated life of the asset.

OTHER REAL ESTATE

Real estate acquired through foreclosure or deed in lieu of foreclosure is recorded at estimated fair value of the property less estimated costs to dispose at the time of acquisition. Write downs from the carrying value of the loan to estimated fair value which are required at the time of foreclosure are charged to the allowance for loan losses. Subsequent adjustments to the carrying values of such properties resulting

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from declines in fair value are charged to operations in the period in which the declines occur.

INCOME TAXES

The Corporation files a consolidated tax return. Deferred tax assets and liabilities are recognized for future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases, and for unused tax loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which temporary

differences are expected to be recovered or settled, or the tax loss carryforwards are expected to be utilized. 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.

TRUST AND INVESTMENT SERVICES INCOME

Assets held in a fiduciary or agency capacity for customers are not included in the accompanying consolidated balance sheets, since such assets are not assets of the Corporation. Trust and Investment Services income is recognized on the accrual method based on contractual rates applied to the balances of individual trust accounts. The market value of trust assets under administration totaled \$1.899 billion at December 31, 2007 and \$1.483 billion at December 31, 2006.

PENSION PLAN

Pension costs, based on actuarial computations of benefits for employees, are charged to current operating results. The Corporation's funding policy is to contribute amounts to the plan sufficient to meet minimum regulatory funding requirements, plus such additional amounts as the Corporation may determine to be appropriate from time to time.

POSTRETIREMENT BENEFITS

The Corporation sponsors a defined benefit health care plan that provides postretirement medical benefits to employees who meet minimum age and service requirements. Postretirement life insurance benefits are also provided to certain employees who retired prior to July 1981.

GOODWILL AND INTANGIBLE ASSETS

Goodwill and other intangible assets carried on the Corporation's consolidated financial statements totaled \$1.5 million and \$5.6 million, respectively, at December 31, 2007.

In accordance with generally accepted accounting principles, the company does not amortize goodwill and instead, at least annually, evaluates whether the carrying value of goodwill has become impaired. A determination that goodwill has become impaired results in immediate write-down of goodwill to its determined value with a resulting charge to operations.

The Corporation's other intangible assets resulted from the purchase of deposits from the Resolution Trust Company in 1994 and the purchase of the trust business of Partners Trust Bank in May of 2007, with balances of \$563 thousand and \$5.1 million, respectively, at December 31, 2007. Both are being amortized to expense over the expected useful life of 15 years. The balances are reviewed for impairment on an ongoing basis or whenever events or changes in business circumstances warrant a review of the carrying value. If impairment is determined to exist, the related write-down of the intangible asset's carrying value is charged to operations.

Based on these impairment reviews, the Corporation determined that goodwill and other intangible assets were not impaired at December 31, 2007.

BASIC EARNINGS PER SHARE

Basic earnings per share is computed on the basis of the weighted average number of common shares outstanding. Issuable shares including those related to directors' restricted stock units and directors stock compensation are considered outstanding and are included in the computation of basic earnings per share as they are earned. The Corporation has no other potentially dilutive stock compensation or stock award arrangements. Earnings per share information is adjusted to present comparative results for stock splits and stock dividends that occur.

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CASH AND CASH EQUIVALENTS

Cash and cash equivalents include cash and amounts due from banks, interest-bearing deposits with other financial institutions, federal funds sold, and U.S. Treasury securities with original terms to maturity of 90 days or less.

SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

The Corporation enters into sales of securities under agreements to repurchase. The agreements are treated as financings, and the obligations to repurchase securities sold are reflected as liabilities in the consolidated balance sheets. The amount of the securities underlying the agreements continues to be carried in the Corporation's securities portfolio. The Corporation has agreed to repurchase securities identical to those sold. The securities underlying the agreements are under the Corporation's control.

OTHER FINANCIAL INSTRUMENTS

The Corporation is a party to certain other financial instruments with off-balance sheet risk such as unused portions of lines of credit and commitments to fund new loans. The Corporation's policy is to record such instruments when funded.

SEGMENT REPORTING

The Corporation's operations are solely in the financial services industry and primarily include the provision of traditional banking and trust services. The Corporation operates primarily in the New York counties of Chemung, Herkimer, Steuben, Schuyler, Tioga, Tompkins and Broome, and the northern tier of Pennsylvania. The Corporation has identified separate operating segments and internal financial information is primarily reported and aggregated in two lines of business, banking and trust and investment advisory services.

RECLASSIFICATION

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

RECENT ACCOUNTING PRONOUNCEMENTS

In September 2006, the Financial Accounting Standards Board ("FASB") released Financial Interpretation No. 48 ("FIN 48"). FIN 48 became effective for fiscal years beginning after December 15, 2006. FIN 48 clarified the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement No. 109 (FASB 109"). This Interpretation prescribes a recognition threshold

and a measurement attribute to determine whether a tax position will ultimately be sustained. The Corporation adopted FIN 48, as of January 1, 2007. A tax position is recognized as a benefit only if it is "more likely than not" that the tax position would be sustained in a tax examination, with a tax examination being presumed to occur. The amount recognized is the largest amount of tax benefit that is greater than 50% likely of being realized on examination. For tax positions not meeting the "more likely than not" test, no tax benefit is recorded. The adoption had no effect on the Corporation's financial statements.

The Corporation is no longer subject to examination by U.S. Federal income taxing authorities for years before 2003, or by New York State taxing authorities for years before 2004. We have no unrecognized tax benefits and do not anticipate any increase in unrecognized benefits over the next 12 months relative to any tax positions taken prior to January 1, 2007.

The Corporation recognizes interest related to income tax matters as interest expense and penalties related to income tax matters as other expense. The Corporation did not have any amounts accrued for interest or penalties at January 1, 2007.

In February 2007, the FASB issued Statement of Financial Accounting Standard No. 159, "The Fair Value Option of Financial Assets and Financial Liabilities" ("FAS 159"). The fair value option, established by this Statement permits entities to choose to measure

eligible items at fair value at specified election dates. The Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted under certain conditions. The Corporation is evaluating the potential effect FAS 159 may have on the Corporation's financial statements at this time.

In September 2006, FASB issued Statement No. 157, Fair Value Measurements ("FAS 157"). FAS 157 defines fair value, establishes a framework for measuring fair value and

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expands disclosures about fair value measurements. This statement establishes a fair value hierarchy about the assumptions used to measure fair value and clarifies assumptions about risk and the effect of a restriction on the sale or use of an asset. In February 2008, the FASB issued FASB Staff Position No. FAS 157-2, which delays the effective date of FAS 157 to fiscal years beginning after November 15, 2008. The Corporation is evaluating the potential effect FAS 157 may have on the Corporation's financial statements at this time.

(2) RESTRICTIONS ON CASH AND DUE FROM BANK ACCOUNTS

The Corporation is required to maintain certain reserves of vault cash and/or deposits with the Federal Reserve Bank of New York. The amount of this reserve requirement was \$750,000 at December 31, 2007.

(3) SECURITIES

Amortized cost and estimated fair value of securities available for sale at December 31, 2007 and 2006 are as follows:

| | <u>2007</u> | | <u>2006</u> | |
|--------------------------------------------------------------------------|-----------------------|-----------------------------|-----------------------|-----------------------------|
| | <u>Amortized Cost</u> | <u>Estimated Fair Value</u> | <u>Amortized Cost</u> | <u>Estimated Fair Value</u> |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 81,752,335 | \$ 81,943,717 | \$ 81,735,482 | \$ 80,133,906 |
| Mortgage-backed securities | 57,005,556 | 56,284,754 | 71,427,061 | 69,205,540 |
| Obligations of states and political subdivisions | 13,371,458 | 13,482,956 | 17,021,991 | 17,083,861 |
| Corporate bonds and notes | 4,351,849 | 4,441,230 | 9,123,500 | 9,275,322 |
| Corporate stocks | <u>828,308</u> | <u>9,168,458</u> | <u>728,542</u> | <u>9,130,922</u> |
| Total | <u>\$ 157,309,506</u> | <u>\$ 165,321,115</u> | <u>\$ 180,036,576</u> | <u>\$ 184,829,551</u> |

Gross unrealized gains and losses on securities available for sale at December 31, 2007 and 2006, were as follows:

| | <u>2007</u> | | <u>2006</u> | |
|--------------------------------------------------------------------------|-------------------------|--------------------------|-------------------------|--------------------------|
| | <u>Unrealized Gains</u> | <u>Unrealized Losses</u> | <u>Unrealized Gains</u> | <u>Unrealized Losses</u> |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 247,667 | \$ 56,285 | \$ - | \$ 1,601,576 |
| Mortgage-backed securities | 85,541 | 806,343 | 24,257 | 2,245,778 |
| Obligations of states and political subdivisions | 129,267 | 17,769 | 128,340 | 66,470 |
| Corporate bonds and notes | 230,816 | 141,435 | 258,465 | 106,643 |
| Corporate stocks | <u>8,340,150</u> | = | <u>8,402,380</u> | = |
| Total | <u>\$ 9,033,441</u> | <u>\$ 1,021,832</u> | <u>\$ 8,813,442</u> | <u>\$ 4,020,467</u> |

Gross realized gains on sales of securities available for sale were \$9,680, \$26,570, and \$6,000 for the years ended December 31, 2007, 2006 and 2005, respectively. There were no realized losses on sales of securities available for sale for the years ended December 31, 2007, 2006 and 2005.

The amortized cost and estimated fair value by years to contractual maturity (mortgage-backed securities are shown as maturing based on the estimated average life at the projected prepayment speed) as of December 31, 2007, for debt securities available for sale are as follows:

Maturing

| | <u>Within One Year</u> | | <u>After One, But Within Five Years</u> | |
|--------------------------------------------------------------------------|------------------------|----------------------|---------------------------------------------|----------------------|
| | <u>Amortized</u> | <u>Fair</u> | <u>Amortized</u> | <u>Fair</u> |
| | <u>Cost</u> | <u>Value</u> | <u>Cost</u> | <u>Value</u> |
| | | | | |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 26,817,467 | \$ 26,877,387 | \$ 44,990,778 | \$ 45,098,491 |
| Mortgage-backed securities | 1,766,907 | 1,767,134 | 47,466,377 | 46,929,547 |
| Obligations of states and political subdivisions | 3,252,209 | 3,275,627 | 5,332,955 | 5,388,391 |
| Corporate bonds and notes | <u>1,851,849</u> | <u>2,082,665</u> | = | = |
| Total | <u>\$ 33,688,432</u> | <u>\$ 34,002,813</u> | <u>\$ 97,790,110</u> | <u>\$ 97,416,429</u> |

Maturing

| | <u>After Five, But Within Ten Years</u> | | <u>After Ten Years</u> | |
|--------------------------------------------------------------------------|---------------------------------------------|---------------------|------------------------|-------------------|
| | <u>Amortized</u> | <u>Fair</u> | <u>Amortized</u> | <u>Fair</u> |
| | <u>Cost</u> | <u>Value</u> | <u>Cost</u> | <u>Value</u> |
| | | | | |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 9,944,091 | \$ 9,967,839 | \$ - | \$ - |
| Mortgage-backed securities | 7,530,117 | 7,345,079 | 242,155 | 242,994 |
| Obligations of states and political subdivisions | 4,786,293 | 4,818,938 | - | - |
| Corporate bonds and notes | <u>2,500,000</u> | <u>2,358,565</u> | = | = |
| Total | <u>\$24,760,501</u> | <u>\$24,490,421</u> | <u>\$ 242,155</u> | <u>\$ 242,994</u> |

Actual maturities may differ from contractual maturities above because issuers may have the right to call or prepay obligations with or without call or prepayment penalties.

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Amortized cost and estimated fair value of securities held to maturity at December 31, 2007 and 2006 are as follows:

| | <u>2007</u> | | <u>2006</u> | |
|--------------------------------------------------|-----------------------|-----------------------------|-----------------------|-----------------------------|
| | <u>Amortized Cost</u> | <u>Estimated Fair Value</u> | <u>Amortized Cost</u> | <u>Estimated Fair Value</u> |
| | | | | |
| Obligations of states and political subdivisions | <u>\$ 4,479,815</u> | <u>\$ 4,575,465</u> | <u>\$ 6,866,209</u> | <u>\$ 6,876,509</u> |
| Total | <u>\$ 4,479,815</u> | <u>\$ 4,575,465</u> | <u>\$ 6,866,209</u> | <u>\$ 6,876,509</u> |

Securities held to maturity had unrealized gains totaling \$209,189 and \$65,286 and unrealized losses totaling \$113,539 and \$54,986 at December 31, 2007 and 2006, respectively. There were no sales of securities held to maturity in 2007, 2006 or 2005.

The contractual maturity of securities held to maturity is as follows at December 31, 2007:

| | Maturing | | | |
|--------------------------------------------------|------------------------|-------------------|---------------------------------------------|---------------------|
| | <u>Within One Year</u> | | <u>After One, But Within Five Years</u> | |
| | <u>Amortized</u> | <u>Fair</u> | <u>Amortized</u> | <u>Fair</u> |
| | <u>Cost</u> | <u>Value</u> | <u>Cost</u> | <u>Value</u> |
| Obligations of states and political subdivisions | <u>\$ 870,842</u> | <u>\$ 870,394</u> | <u>\$ 1,819,890</u> | <u>\$ 1,901,741</u> |
| Total | <u>\$ 870,842</u> | <u>\$ 870,394</u> | <u>\$ 1,819,890</u> | <u>\$ 1,901,741</u> |

| | Maturing | | | |
|--------------------------------------------------|---------------------------------------------|---------------------|------------------------|-------------------|
| | <u>After Five, But Within Ten Years</u> | | <u>After Ten Years</u> | |
| | <u>Amortized</u> | <u>Fair</u> | <u>Amortized</u> | <u>Fair</u> |
| | <u>Cost</u> | <u>Value</u> | <u>Cost</u> | <u>Value</u> |
| Obligations of states and political subdivisions | <u>\$ 1,334,083</u> | <u>\$ 1,272,383</u> | <u>\$ 455,000</u> | <u>\$ 530,947</u> |
| Total | <u>\$ 1,334,083</u> | <u>\$ 1,272,383</u> | <u>\$ 455,000</u> | <u>\$ 530,947</u> |

Temporarily impaired investments in securities available for sale and held to maturity that had been in a continuous unrealized loss position at December 31, 2007 and December 31, 2006 were as follows:

| | <u>Less than 12 months</u> | | <u>12 months or longer</u> | | <u>Total</u> | |
|--------------------------------------------------------------------------|----------------------------|------------------------------|----------------------------|------------------------------|-------------------|------------------------------|
| | <u>Fair Value</u> | <u>Unrealized Losses</u> | <u>Fair Value</u> | <u>Unrealized Losses</u> | <u>Fair Value</u> | <u>Unrealized Losses</u> |
| <u>2007</u> | | | | | | |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 9,962,914 | \$ 30,239 | \$ 6,791,421 | \$ 26,046 | \$ 16,754,335 | \$ 56,285 |
| Mortgage-backed securities | 5,388,672 | 24,285 | 42,126,817 | 782,058 | 47,515,489 | 806,343 |
| Obligations of states and political subdivisions | 602,253 | 113,539 | 2,176,945 | 17,769 | 2,779,198 | 131,308 |
| Corporate bonds and notes | - | - | 2,358,565 | 141,435 | 2,358,565 | 141,435 |
| Corporate stocks | = | = | = | = | = | = |

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| | | | | | | |
|------------------------------------------------------------------------|----------------------------|--------------------------|----------------------------|--------------------------|----------------------|--------------------------|
| Total temporarily impaired securities | <u>\$ 15,953,839</u> | <u>\$ 168,063</u> | <u>\$ 53,453,748</u> | <u>\$ 967,308</u> | <u>\$ 69,407,587</u> | <u>\$1,135,371</u> |
| | <u>Less than 12 months</u> | | <u>12 months or longer</u> | | <u>Total</u> | |
| <u>2006</u> | <u>Fair Value</u> | <u>Unrealized Losses</u> | <u>Fair Value</u> | <u>Unrealized Losses</u> | <u>Fair Value</u> | <u>Unrealized Losses</u> |
| Obligations of U.S. Government and US Government sponsored enterprises | \$ - | \$ - | \$ 80,133,906 | \$ 1,601,576 | \$80,133,906 | \$ 1,601,576 |
| Mortgage-backed securities | 5,699,312 | 9,930 | 61,370,391 | 2,235,848 | 67,069,703 | 2,245,778 |
| Obligations of states and political subdivisions | 5,061,655 | 15,984 | 5,215,010 | 105,473 | 10,276,665 | 121,457 |
| Corporate bonds and notes | 4,896,963 | 103,038 | 1,246,341 | 3,605 | 6,143,304 | 106,643 |
| Corporate stocks | = | = | = | = | = | = |
| Total temporarily impaired securities | <u>\$ 15,657,930</u> | <u>\$ 128,952</u> | <u>\$147,965,648</u> | <u>\$3,946,502</u> | <u>\$163,623,578</u> | <u>\$4,075,454</u> |

Declines in the fair value of held to maturity and available for sale securities below their cost that are deemed to be other than temporary are reflected in earnings as realized losses. In estimating other-than-temporary impairment losses, management considers, among other things, (i) the length of time and the extent to which the fair value has been less than cost, (ii) the financial condition and near-term prospects of the issuer, and (iii) the intent and ability of the Corporation to retain its investment in the issuer for a period of time sufficient to allow for any anticipated recovery in fair value.

Management has the ability and intent to hold the securities classified as held to maturity until they mature, at which time the Corporation expects to receive full value for the securities. Furthermore, as of December 31, 2007, management also had the

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ability and intent to hold the securities classified as available for sale for a period of time sufficient for a recovery of cost. Approximately 92.6% of the securities above in an unrealized loss position at December 31, 2007 are obligations of U.S. Government-sponsored enterprises and mortgage-backed securities issued by U.S. Government-sponsored enterprises. The temporary impairment is directly related to changes in market interest rates. In general, as interest rates rise, the fair value of fixed-rate securities will decrease and, as interest rates fall, the fair value of fixed-rate securities will increase. At December 31, 2007, the Corporation holds two U.S. Government-sponsored enterprises, seventeen mortgage-backed securities issued by U.S. Government-sponsored enterprises, one corporate bond and eight municipal obligations with unrealized losses greater than 12 months. These temporary impairments are due to their direct relationship to the movement in market interest rates, rather than to credit quality issues. Overall, the impairments are deemed temporary based on the direct relationship of the declines in fair value to movements in the

interest rates, as well as the relatively short duration of the investments and their credit quality.

Accordingly, as of December 31, 2007, management believes the impairments detailed in the table above are temporary and no impairment loss has been realized in the Corporation's consolidated income statements.

Interest and dividend income on securities for the years ended December 31, 2007, 2006 and 2005 was as follows:

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|--------------------------------------------------------------------------|---------------------|---------------------|---------------------|
| Taxable: | | | |
| Obligations of U.S. Government and U.S. Government sponsored enterprises | \$ 3,509,949 | \$ 3,714,249 | \$ 4,711,055 |
| Mortgage-backed securities | 2,648,457 | 3,327,024 | 3,556,211 |
| Corporate bonds and notes | 354,329 | 755,114 | 747,208 |
| Corporate stocks | 474,530 | 413,607 | 424,055 |
| Exempt from Federal taxation: | | | |
| Obligations of states and political subdivisions | <u>794,630</u> | <u>977,913</u> | <u>1,004,524</u> |
| Total | <u>\$ 7,781,895</u> | <u>\$ 9,187,907</u> | <u>\$10,443,053</u> |

The fair value of securities pledged to secure public funds on deposit or for other purposes as required by law was \$135,425,736 at December 31, 2007 and \$146,018,769 at December 31, 2006. This includes mortgage-backed securities totaling \$15,230,787 and \$22,223,385 (fair value of \$15,050,527 and \$21,637,656), and obligations of U.S. Government sponsored enterprises totaling \$32,834,062 and \$28,832,460 (fair value of \$32,936,536 and \$28,348,424), pledged to secure securities sold under agreements to repurchase at December 31, 2007 and 2006, respectively.

There are no securities of a single issuer (other than securities of U.S. Government sponsored enterprises) that exceed 10% of shareholders' equity at December 31, 2007 or 2006.

The Corporation has equity investments in Southern Tier Business Development, LLC and Cephas Capital Partners, L.P. These small business investment companies were established for the purpose of providing financing to small businesses in market areas served by the Corporation, including minority-owned small businesses and those that are anticipated to create jobs for the low to moderate income levels in the targeted areas. As of December 31, 2007 and 2006, these investments totaled \$2,507,209 and \$2,707,255, respectively, are included in other assets, and are accounted for under the equity method of accounting.

(4) LOANS AND ALLOWANCE FOR LOAN LOSSES

The composition of the loan portfolio, net of deferred origination fees and cost, and unearned income is summarized as follows:

| <u>December 31,</u> | <u>2007</u> | <u>2006</u> |
|---------------------|-------------|-------------|
|---------------------|-------------|-------------|

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| | | |
|----------------------------------------|----------------------|----------------------|
| Residential mortgages | \$159,626,837 | \$133,588,409 |
| Commercial mortgages | 70,631,809 | 54,666,318 |
| Commercial, financial and agricultural | 131,071,275 | 138,342,437 |
| Indirect consumer loans | 90,737,964 | 66,443,422 |
| Consumer loans | <u>87,454,605</u> | <u>84,623,293</u> |
| | <u>\$539,522,490</u> | <u>\$477,663,879</u> |

Residential mortgages held for sale as of December 31, 2007 were \$39,400. There were no residential mortgages held for sale as of December 31, 2006.

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Included in consumer loans are student loans that have yet to enter repayment status totaling \$6,428,484 at December 31, 2007 and \$5,912,821 at December 31, 2006, respectively. Once these loans enter repayment status they are considered held for sale and are sold to a third party. These loans are adjustable rate and their unpaid principal balance approximates their fair value.

Residential mortgages totaling \$102,924,019 at December 31, 2007, and \$78,352,021 at December 31, 2006, were pledged under a blanket collateral agreement for the Corporation's line of credit with the FHLB.

The Corporation's market area encompasses the New York State counties of Broome, Chemung, Herkimer, Schuyler, Steuben, Tioga, and Tompkins, as well as the northern tier of Pennsylvania. Substantially all of the Corporation's outstanding loans are with borrowers living or doing business within 25 miles of the Corporation's branches in these counties. The Corporation's concentrations of credit risk by loan type are reflected in the preceding table. The concentrations of credit risk with standby letters of credit, committed lines of credit and commitments to originate new loans, generally follow the loan classifications in the table above. Other than general economic risks, management is not aware of any material concentrations of credit risk to any industry or individual borrower.

The following table summarizes the Corporation's non-performing loans at December 31, 2007 and 2006:

| | <u>2007</u> | <u>2006</u> |
|------------------------------------------------------------|---------------------|---------------------|
| Non-accrual loans | \$ 2,224,622 | \$ 2,859,922 |
| Troubled debt restructurings | 830,258 | 329,401 |
| Loans 90 days or more past due and still accruing interest | <u>517,967</u> | <u>420,515</u> |
| Total non-performing loans | <u>\$ 3,572,847</u> | <u>\$ 3,609,838</u> |

The total amount of interest income that would have been recorded if the above non-accrual and troubled debt restructured loans had been current in accordance with their original terms and had been outstanding throughout the period or since origination, if held for part of the period, in 2007, 2006 and 2005 was \$234,716, \$358,703 and \$768,045, respectively. Interest income was recognized in 2007, 2006 and 2005 on those loans in the amount of \$58,818, \$29,273, and \$26,239, respectively. The Corporation is not committed to advance additional funds to borrowers with non-performing loans.

Transactions in the allowance for loan losses for the years ended December 31, 2007, 2006 and 2005 were as follows:

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|---------------------------------|---------------------|---------------------|---------------------|
| Balances at January 1 | \$ 7,983,256 | \$ 9,777,643 | \$ 9,983,279 |
| Provision charged to operations | 1,255,000 | 125,000 | 1,300,000 |
| Loans charged-off | (1,288,267) | (2,144,629) | (1,776,036) |
| Recoveries | <u>502,830</u> | <u>225,242</u> | <u>270,400</u> |
| Balances at December 31 | <u>\$ 8,452,819</u> | <u>\$ 7,983,256</u> | <u>\$ 9,777,643</u> |

At December 31, 2007 and 2006, the recorded investment in loans that are considered to be impaired totaled \$2,634,969 and \$2,751,400, respectively. Included in the 2007 amount are impaired loans of \$789,791 for which an impairment allowance has been recognized. The related impairment allowance was \$340,807. The 2006 amount includes \$317,521 of impaired loans with a related impairment allowance of \$224,521. The average recorded investment in impaired loans during 2007, 2006 and 2005 was \$2,487,040, \$5,556,480 and \$9,024,337, respectively. During 2007, interest income recognized on impaired loans during the period the loans were impaired totaled \$44,094, none of which was recognized on a cash-basis. During 2006, interest income recognized on impaired loans during the period the loans were impaired totaled \$26,340, of which \$3,200 was recognized on a cash-basis. During 2005, interest income recognized on impaired loans during the period the loans were impaired totaled \$12,230, of which \$3,739 was recognized on a cash-basis.

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(5) PREMISES & EQUIPMENT

Premises and equipment at December 31, 2007 and 2006 are as follows:

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| | <u>2007</u> | <u>2006</u> |
|------------------------------------------------|---------------------|---------------------|
| Land | \$ 3,371,408 | \$ 3,371,408 |
| Buildings | 27,776,601 | 25,161,970 |
| Equipment and furniture | 25,872,219 | 24,842,007 |
| Leasehold improvements | <u>709,997</u> | <u>646,081</u> |
| | \$57,730,225 | \$54,021,466 |
| Less accumulated depreciation and amortization | <u>34,510,119</u> | <u>32,299,372</u> |
| | <u>\$23,220,106</u> | <u>\$21,722,094</u> |

Depreciation expense was \$2,618,987, \$2,604,689 and \$2,414,031 for 2007, 2006 and 2005, respectively.

(6) INTANGIBLE ASSETS

The following table presents information relative to the Corporation's core deposit intangible ("CDI") related to the acquisition of deposits from the Resolution Trust Company in 1994:

| | <u>At December 31, 2007</u> | <u>At December 31, 2006</u> |
|----------------------------------|-----------------------------|-----------------------------|
| Original core deposit intangible | \$ 5,965,794 | \$ 5,965,794 |
| Less: Accumulated amortization | <u>5,402,357</u> | <u>5,004,638</u> |
| Carrying amount | <u>\$ 563,437</u> | <u>\$ 961,156</u> |

Amortization expense for the twelve months ended December 31, 2007 and 2006 related to the CDI was \$397,719. As of December 31, 2007, the remaining amortization period for the Corporation's CDI was approximately 1.42 years. The estimated amortization expense is \$397,719 for the year ending December 31, 2008, with \$165,718 in amortization expense in 2009.

The following table presents information relative to the Corporation's purchase of the trust business of Partners Trust Financial Group, Inc. on May 3, 2007. At that time, the Corporation acquired \$351 million of trust assets under administration at fair value:

| | <u>At December 31, 2007</u> |
|-------------------------------------------|-----------------------------|
| Original customer relationship intangible | \$ 5,301,983 |
| Less: Accumulated amortization | <u>235,644</u> |
| Carrying amount | <u>\$ 5,066,339</u> |

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Amortization expense as of December 31, 2007 related to the customer relationship intangible was \$235,644. As of December 31, 2007, the remaining amortization period was approximately 14.33 years. The estimated amortization expense is \$353,466 for the years ending December 31, 2008 through December 31, 2021, with \$117,815 in amortization expense in 2022.

(7) DEPOSITS

A summary of deposits at December 31, 2007 and 2006 is as follows:

| | <u>2007</u> | <u>2006</u> |
|--------------------------------------|----------------------|----------------------|
| Non-interest-bearing demand deposits | \$145,491,880 | \$151,600,733 |
| Interest-bearing demand deposits | 35,032,109 | 36,392,594 |
| Insured money market accounts | 64,745,005 | 64,249,395 |
| Savings deposits | 100,160,233 | 102,236,605 |
| Time deposits | <u>227,170,702</u> | <u>230,612,550</u> |
| | <u>\$572,599,929</u> | <u>\$585,091,877</u> |

Time deposits include certificates of deposit in denominations of \$100,000 or more aggregating \$63,851,391 and \$73,079,757 at December 31, 2007 and 2006, respectively. Interest expense on such certificates was \$4,109,885, \$3,421,388 and \$1,412,071 for 2007, 2006 and 2005, respectively.

Scheduled maturities of time deposits at December 31, 2007, are summarized as follows:

| | |
|---------------------|----------------------|
| 2008 | \$165,443,003 |
| 2009 | 37,609,516 |
| 2010 | 11,612,239 |
| 2011 | 6,020,597 |
| 2012 | 6,320,092 |
| 2013 and thereafter | <u>165,255</u> |
| | <u>\$227,170,702</u> |

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(8) SECURITIES SOLD UNDER AGREEMENTS TO REPURCHASE

A summary of securities sold under agreements to repurchase as of and for the years ended December 31, 2007, 2006

and 2005 is as follows:

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|-------------------------------------------------|--------------|--------------|--------------|
| Securities sold under agreements to repurchase: | | | |
| Balance at December 31 | \$31,212,292 | \$35,023,948 | \$60,855,665 |
| Maximum month-end balance | \$40,312,166 | \$51,979,980 | \$72,697,469 |
| Average balance during year | \$36,032,437 | \$40,342,384 | \$69,068,495 |
| Weighted-average rate at December 31 | 4.43% | 5.18% | 4.05% |
| Average rate paid during year | 5.12% | 5.03% | 3.82% |

Information concerning outstanding securities repurchase agreements as of December 31, 2007 is summarized as follows:

| <u>Remaining Term to Final Maturity</u> <u>(1)</u> | <u>Repurchase</u> <u>Liability</u> | <u>Accrued</u> <u>Interest</u> <u>Payable</u> | <u>Weighted-</u> <u>Average Rate</u> | <u>Estimated Fair</u> <u>Value of Collateral</u> <u>Securities (2)</u> |
|-------------------------------------------------------|---------------------------------------|-----------------------------------------------------|-----------------------------------------|------------------------------------------------------------------------------|
| Within 90 days | \$ 8,712,292 | \$ - | 2.44% | \$19,321,946 |
| After 90 days but with one year | 10,000,000 | 62,172 | 5.89% | 11,414,864 |
| After one year but within five years | 2,500,000 | 4,192 | 5.03% | 3,429,420 |
| After five years but within ten years | <u>10,000,000</u> | <u>15,133</u> | <u>4.54%</u> | <u>10,126,180</u> |
| Total | <u>\$31,212,292</u> | <u>\$ 81,497</u> | <u>4.43%</u> | <u>\$44,292,410</u> |

1. The weighted-average remaining term to final maturity was approximately 3.3 years at December 31, 2007. At December 31, 2007, \$22.5 million of the securities repurchase agreements contained call provisions. The weighted-average rate at December 31, 2007 on the callable securities repurchase agreements was 5.19%, with a weighted-average remaining period of approximately 5 months to the call date. At December 31, 2007, \$8.7 million of the securities repurchase agreements did not contain call provisions. The weighted-average rate at December 31, 2007 on the non-callable securities repurchase agreements was 2.44%, with a weighted-average term to maturity of approximately 2 days.

2. Represents the estimated fair value of the securities subject to the repurchase agreements, including accrued interest receivable, of approximately \$317 thousand at December 31, 2007.

(9) FEDERAL HOME LOAN BANK TERM ADVANCES AND OVERNIGHT ADVANCES

The following is a summary of Federal Home Loan Bank advances at December 31, 2007 and 2006:

2007

| <u>Amount</u> | <u>Weighted-Average Rate</u> | <u>Maturity</u> | <u>Call Date</u> |
|----------------------|----------------------------------|-------------------|-------------------|
| \$ 62,400,000 | 4.11% | January 2, 2008 | - |
| 10,000,000 | 4.77% | July 27, 2012 | July 27, 2009 |
| <u>10,000,000</u> | <u>4.60%</u> | December 22, 2016 | December 22, 2011 |
| <u>\$ 82,400,000</u> | <u>4.25%</u> | | |

2006

| <u>Amount</u> | <u>Weighted-Average Rate</u> | <u>Maturity</u> | <u>Call Date</u> |
|----------------------|----------------------------------|--------------------|-------------------|
| \$ 7,900,000 | 5.390% | January 2, 2007 | - |
| 10,000,000 | 3.720% | September 13, 2007 | - |
| <u>10,000,000</u> | <u>4.603%</u> | December 22, 2016 | December 22, 2011 |
| <u>\$ 27,900,000</u> | <u>4.509%</u> | | |

Residential mortgages totaling \$102,924,019 and \$78,352,021, at December 31, 2007 and 2006, respectively, were pledged under a blanket collateral agreement for the Corporation's advances with the FHLB.

(10) INCOME TAXES

For the years ended December 31, 2007, 2006 and 2005, income tax expense attributable to income from operations consisted of the following:

| Current: | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|------------------|---------------------|---------------------|---------------------|
| State | \$ (6,698) | \$ 2,287 | \$ 124,790 |
| Federal | <u>3,065,672</u> | <u>(1,361,224)</u> | <u>2,029,304</u> |
| | 3,058,974 | (1,358,937) | 2,154,094 |
| Deferred expense | <u>471,138</u> | <u>3,980,216</u> | <u>391,994</u> |
| | <u>\$ 3,530,112</u> | <u>\$ 2,621,279</u> | <u>\$ 2,546,088</u> |

Income tax expense differed from the amounts computed by applying the U.S. Federal statutory income tax rate to income before income tax expense as follows:

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|--------------------------------|--------------|--------------|--------------|
| Tax computed at statutory rate | \$ 3,668,428 | \$ 3,131,347 | \$ 3,106,114 |

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| | | | |
|------------------------------------|---------------------|---------------------|---------------------|
| Tax-exempt interest | (423,251) | (499,907) | (575,228) |
| Dividend exclusion | (43,773) | (50,241) | (42,810) |
| State taxes, net of Federal impact | 353,888 | 53,719 | 150,456 |
| Nondeductible interest expense | 45,605 | 48,230 | 42,742 |
| Other items, net | <u>(70,785)</u> | <u>(61,869)</u> | <u>(135,186)</u> |
| Actual income tax expense | <u>\$ 3,530,112</u> | <u>\$ 2,621,279</u> | <u>\$ 2,546,088</u> |

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The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at December 31, 2007 and 2006, are presented below:

| | <u>2007</u> | <u>2006</u> |
|----------------------------------------------------------------|----------------------|---------------------|
| Deferred tax assets: | | |
| Allowance for loan losses | \$ 3,270,058 | \$ 3,109,478 |
| Accrual for employee benefit plans | 1,045,961 | 1,078,066 |
| Depreciation | 601,141 | 404,315 |
| Deferred compensation and directors' fees | 809,775 | 767,734 |
| Tax attribute carryforwards | 259,414 | 637,895 |
| Accounting for defined benefit pension and other benefit plans | 343,324 | 644,736 |
| Other | <u>302,895</u> | <u>512,402</u> |
| Total gross deferred tax assets | <u>\$ 6,632,568</u> | <u>\$ 7,154,626</u> |
| Deferred tax liabilities: | | |
| Deferred loan fees and costs | \$ 929,945 | 696,381 |
| Prepaid pension | 4,850,463 | 4,769,779 |
| Net unrealized gains on securities available for sale | 3,099,371 | 1,866,863 |
| Accrued trust fees | 255,219 | - |
| Other | <u>219,083</u> | <u>197,765</u> |
| Total gross deferred tax liabilities | <u>9,354,081</u> | <u>7,530,788</u> |
| Net deferred tax (liability) asset | <u>\$(2,721,513)</u> | <u>\$(376,162)</u> |

Realization of deferred tax assets is dependent upon the generation of future taxable income or the existence of sufficient taxable income within the loss carryback period. A valuation allowance is recognized 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.

The Corporation has a capital loss carryover of \$111 thousand, which expires in 2011. The Corporation also has a New York State net operating loss carryforward of \$3.8 million, which expires in 2026, a New York State charitable contribution carryforward of \$233 thousand, which expires in 2011, and a \$41 thousand New York State tax credit carryforward that is not subject to expiration.

(11) PENSION PLAN AND OTHER BENEFIT PLANS

The Corporation has a noncontributory defined benefit pension plan covering substantially all employees. The plan's defined benefit formula generally bases payments to retired employees upon their length of service multiplied by a percentage of the average monthly pay over the last five years of employment.

The Corporation uses a December 31 measurement date for its pension plan.

The following table presents (1) changes in the plan's projected benefit obligation and plan assets, and (2) the plan's funded status at December 31, 2007 and 2006:

| | | |
|------------------------------------------------|---------------------|---------------------|
| Change in projected benefit obligation: | <u>2007</u> | <u>2006</u> |
| Benefit obligation at beginning of year | \$21,884,089 | \$21,350,128 |
| Service cost | 646,922 | 597,449 |
| Interest cost | 1,309,689 | 1,227,107 |
| Amendments | - | 80,518 |
| Actuarial (gain) loss | 483,095 | (330,514) |
| Benefits paid | <u>(1,068,897)</u> | <u>(1,040,599)</u> |
| Benefit obligation at end of year | <u>\$23,254,898</u> | <u>\$21,884,089</u> |
| Change in plan assets: | | |
| Fair value of plan assets at beginning of year | \$31,815,033 | \$20,848,669 |
| Actual return on plan assets | 3,597,574 | 2,006,963 |
| Employer contributions | - | 10,000,000 |
| Benefits paid | <u>(1,068,897)</u> | <u>(1,040,599)</u> |
| Fair value of plan assets at end of year | <u>\$34,343,710</u> | <u>\$31,815,033</u> |
| Funded status | <u>\$11,088,812</u> | <u>\$ 9,930,944</u> |

Amount recognized in accumulated other comprehensive income at December 31, 2007 and 2006 consist of the following:

| | |
|-------------|-------------|
| <u>2007</u> | <u>2006</u> |
|-------------|-------------|

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| | | |
|-------------------------------------|---------------------|---------------------|
| Net actuarial loss | \$ 1,931,169 | \$ 2,543,547 |
| Prior service cost | 302,774 | 391,446 |
| Unrecognized net initial obligation | <u>798</u> | <u>70,686</u> |
| Total before tax effects | <u>\$ 2,234,741</u> | <u>\$ 3,005,679</u> |

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The accumulated benefit obligation at December 31, 2007 and 2006 was \$19,719,789 and \$18,641,503, respectively.

The principal actuarial assumptions used in determining the projected benefit obligation as of December 31, 2007, 2006 and 2005 were as follows:

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|----------------------------------------------|-------------|-------------|-------------|
| Discount rate | 6.00% | 6.00% | 5.75% |
| Assumed rate of future compensation increase | 5.00% | 5.00% | 5.00% |

Components of net periodic benefit cost in 2007, 2006 and 2005 consist of the following:

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|------------------------------------------------------------------------------------------------|-----------------------|-------------------|-------------------|
| Net periodic benefit cost | | | |
| Service cost, benefits earned during the year | \$ 646,922 | \$ 597,449 | \$ 529,372 |
| Interest cost on projected benefit obligation | 1,309,689 | 1,227,107 | 1,165,480 |
| Expected return on plan assets | (2,502,101) | (1,726,063) | (1,574,697) |
| Recognized prior service cost | 88,672 | 88,672 | 81,352 |
| Recognized actuarial loss | - | 138,640 | - |
| Recognized net initial obligation | <u>69,888</u> | <u>69,888</u> | <u>69,888</u> |
| Net periodic (benefit) cost | <u>\$ (386,930)</u> | <u>\$ 395,693</u> | <u>\$ 271,395</u> |
| Other changes in plan assets and benefit obligations recognized in other comprehensive income: | | | |
| Net actuarial gain | (612,378) | | |
| Recognized prior service cost | (88,672) | | |
| Recognized net initial obligation | <u>(69,888)</u> | | |
| Total recognized in other comprehensive income (before tax effect) | <u>\$ (770,938)</u> | | |
| Total recognized in net benefit cost and other comprehensive income (before tax effect) | <u>\$ (1,157,868)</u> | | |

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During 2007, the plan's total unrecognized net loss decreased by \$612 thousand. The variance between the actual and expected return on plan assets during 2007 decreased the total unrecognized net loss by \$1.1 million. Because the total unrecognized net gain or loss is less than the greater of 10% of the projected benefit obligation or 10% of the plan assets, no amortization is anticipated in 2008. Actual results for 2008 will depend on the 2008 actuarial valuation of the plan.

Amounts expected to be recognized in net periodic cost during 2008

| | |
|------------------------------------|-----------|
| Prior service cost recognition | \$ 88,672 |
| Net initial obligation recognition | \$ 798 |

The principal actuarial assumptions used in determining the net periodic benefit cost for the years ended December 31, 2007, 2006 and 2005 were as follows:

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|----------------------------------------------|-------------|-------------|-------------|
| Discount rate | 6.00% | 5.75% | 6.00% |
| Expected long-term rate of return on assets | 8.00% | 8.00% | 8.00% |
| Assumed rate of future compensation increase | 5.00% | 5.00% | 5.00% |

The Corporation changes important assumptions whenever changing conditions warrant. The discount rate is typically changed at least annually and the expected long-term return on plan assets will typically be revised every three to five years, or as conditions warrant. Other material assumptions include the compensation increase rates, rates of employee terminations, and rates of participant mortality.

The expected return on plan assets was determined based on historical and expected future returns of the various asset classes, using the target allocations described below.

The Corporation's pension plan weighted-average asset allocation at December 31, 2007 and 2006, and the target allocation for 2007 by asset category are as follows:

| <u>Asset Category</u> | <u>Target Allocation 2008</u> | <u>Percentage of Plan Assets at December 31,</u> | | <u>Weighted-Average Expected Long-Term Rate of Return</u> |
|-----------------------|-------------------------------|--------------------------------------------------|-------------|-----------------------------------------------------------|
| | | <u>2007</u> | <u>2006</u> | |
| Equity securities | 40% - 75% | 74% | 46% | 10.0% |
| Debt securities | 20% - 50% | 16% | 19% | 6.0% |
| Cash | 0% - 20% | <u>10%</u> | <u>35%</u> | <u>4.0%</u> |
| Total | | <u>100%</u> | <u>100%</u> | <u>8.2%</u> |

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The plan's investment policy includes a mandate to diversify assets and invest in a variety of asset classes to achieve that goal. The plan's assets are currently invested in a variety of funds representing most standard equity and debt security classes. While no significant changes in the asset allocation are expected during the

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upcoming year, the Corporation may make changes at any time. Late in 2006, a tax deductible contribution of \$10,000,000 was made to the plan. Management's decision to make this contribution was based upon the favorable tax treatment of this contribution as well as the expectation that future plan earnings associated with this investment will significantly reduce future pension expense.

As of December 31, 2007 and 2006, the Corporation's pension plan did not hold any direct investment in the Corporation's common stock.

The following table presents the estimated benefit payments for each of the next five years and the aggregate amount expected to be paid in years six through ten for the pension plan:

| <u>Calendar Year</u> | <u>Future Expected Benefit Payments</u> |
|----------------------|---------------------------------------------|
| 2008 | \$ 1,145,000 |
| 2009 | \$ 1,150,000 |
| 2010 | \$ 1,160,000 |
| 2011 | \$ 1,230,000 |
| 2012 | \$ 1,320,000 |
| 2013-2017 | \$ 7,755,000 |

The Pension Plan was amended effective January 1, 2006 to slightly improve early retirement factors at ages 55 through 59 and change the definition of actuarial equivalence.

The Corporation does not expect to contribute to the plan during 2008. Funding requirements for subsequent years are uncertain and will significantly depend on changes in assumptions used to calculate plan funding levels, the actual return on plan assets, changes in the employee groups covered by the plan, and any legislative or regulatory changes affecting plan funding requirements.

For tax planning, financial planning, cash flow management or cost reduction purposes the Corporation may increase, accelerate, decrease or delay contributions to the plan to the extent permitted by law.

The Corporation also sponsors a defined contribution profit sharing, savings and investment plan which covers all

eligible employees with a minimum of 1,000 hours of annual service. The Corporation makes discretionary matching and profit sharing contributions to the plan based on the financial results of the Corporation. Expense under the plan totaled \$255,468, \$223,041, and \$204,325 for the years ended December 31, 2007, 2006 and 2005, respectively. The plan's assets at December 31, 2007 and 2006, include 168,016 and 162,999 shares, respectively, of Chemung Financial Corporation common stock, as well as other common and preferred stocks, U.S. Government securities, corporate bonds and notes, and mutual funds.

The Corporation sponsors a defined benefit health care plan that provides postretirement medical benefits to employees who meet minimum age and service requirements. Postretirement life insurance benefits are also provided to certain employees who retired prior to July 1981. This plan was amended effective July 1, 2006. Prior to this amendment, all retirees age 55 or older were eligible for coverage under the Corporation's self insured health care plan, contributing 40% of the cost of the coverage. Under the amended plan, coverage for Medicare eligible retirees who reside in the Central New York geographic area is provided under a group sponsored plan with Blue Cross Blue Shield called Medicare Blue PPO, with the retiree paying 100% of the cost of coverage. Blue Cross Blue Shield assumes full liability for the payment of health care benefits incurred after July 1, 2006. Current Medicare eligible retirees who reside outside of the Central New York geographic area, as well as current and future retirees between the ages of 55 and 65, will continue to be eligible for coverage under the Corporation's self insured plan, with the retiree contribution increasing from 40% to 50%. Employees who retire after July 1, 2006, and become Medicare eligible will only have access to the Medicare Blue PPO plan. Additionally, effective July 1, 2006, dental benefits were eliminated for all retirees.

The Corporation uses a December 31 measurement date for its postretirement medical benefits plan.

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The following table presents (1) changes in the plan's accumulated postretirement benefit obligation and (2) the plan's funded status at December 31, 2007 and 2006:

| Changes in accumulated postretirement benefit obligation: | <u>2007</u> | <u>2006</u> |
|--------------------------------------------------------------------|---------------------|---------------------|
| Accumulated postretirement benefit obligation at beginning of year | \$ 1,284,101 | \$ 4,035,575 |
| Service cost | 27,000 | 43,000 |
| Interest cost | 71,000 | 148,000 |
| Participant contributions | 60,698 | 96,955 |
| Amendments | - | (2,308,000) |
| Actuarial gain | (112,193) | (387,627) |
| Benefits paid | (139,027) | (343,802) |
| Retiree drug subsidy received | <u>23,614</u> | = |
| Accumulated postretirement benefit obligation at end of year | <u>\$ 1,215,193</u> | <u>\$ 1,284,101</u> |

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Change in plan assets:

| | | |
|------------------------------------------------|----------------------|----------------------|
| Fair value of plan assets at beginning of year | \$ - | \$ - |
| Employer contribution | 54,715 | 246,847 |
| Plan participants' contributions | 60,698 | 96,955 |
| Benefits paid | (139,027) | (343,802) |
| Retiree drug subsidy received | <u>23,614</u> | = |
| Fair value of plan assets at end of year | <u>\$ -</u> | <u>\$ -</u> |
| Funded status | <u>\$(1,215,193)</u> | <u>\$(1,284,101)</u> |

Amount recognized in accumulated other comprehensive income at December 31, 2007 and 2006 consist of the following:

| | <u>2007</u> | <u>2006</u> |
|--------------------------|----------------------|----------------------|
| Net actuarial loss | \$ (286,874) | \$ (181,681) |
| Prior service benefit | <u>(1,210,000)</u> | <u>(1,307,000)</u> |
| Total before tax effects | <u>\$(1,496,874)</u> | <u>\$(1,488,681)</u> |

| Weighted-average assumption for disclosure as of December 31,: | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|----------------------------------------------------------------|-------------|-------------|-------------|
| Discount rate | 6.00% | 6.00% | 5.75% |
| Health care cost trend: Initial | 9.00% | 9.00% | 9.50% |
| Health care cost trend: Ultimate | 4.50% | 4.50% | 4.50% |
| Year ultimate reached | 2016 | 2016 | 2016 |

The components of net periodic postretirement benefit cost for the years ended December 31, 2007, 2006 and 2005 are as follows:

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|--------------------------------------------|-------------------|-------------------|-------------------|
| Service cost | \$ 27,000 | \$ 43,000 | \$ 63,000 |
| Interest cost | 71,000 | 148,000 | 227,000 |
| Recognized prior service (benefit) cost | (97,000) | 8,000 | 113,000 |
| Recognized actuarial gain | <u>(7,000)</u> | <u>(5,000)</u> | = |
| Net periodic postretirement (benefit) cost | <u>\$ (6,000)</u> | <u>\$ 194,000</u> | <u>\$ 403,000</u> |

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Other changes in plan assets and benefit obligations recognized in other comprehensive income:

| | |
|-----------------------------------------------------------------------------------------|--------------------|
| Net actuarial gain | (112,193) |
| Recognized acutuarial gain | 7,000 |
| Prior service benefit | - |
| Recognized prior service benefit (cost) | <u>97,000</u> |
| Total recognized in other comprehensive income (before tax effect) | <u>\$ (8,193)</u> |
| Total recognized in net benefit cost and other comprehensive income (before tax effect) | <u>\$ (14,193)</u> |

Amounts expected to be recognized in net periodic cost during 2008:

| | |
|--------------------------------|-------------|
| Gain recognition | \$ (12,000) |
| Prior service cost recognition | \$ (97,000) |

| | | | |
|-------------------------------------------------------|-------------|-------------|-------------|
| Effect of a 1% increase in health care trend rate on: | <u>2007</u> | <u>2006</u> | <u>2005</u> |
| Benefit obligation | \$ 26,000 | \$ 33,000 | \$ 8,000 |
| Total service and interest cost | 2,000 | \$ 2,000 | \$ (1,000) |

| | | | |
|-------------------------------------------------------|-------------|-------------|-------------|
| Effect of a 1% decrease in health care trend rate on: | | | |
| Benefit obligation | \$ (33,000) | \$ (37,000) | \$ (20,000) |
| Total service and interest cost | \$ (2,000) | \$ (2,000) | \$ - |

| | | | |
|------------------------------------------------------------------------|-------------|-------------|-------------|
| Weighted-average assumptions for net periodic cost as of December 31,: | <u>2007</u> | <u>2006</u> | <u>2005</u> |
| Discount rate | 6.00% | 5.75% | 6.00% |
| Health care cost trend: Initial | 9.00% | 9.50% | 7.75% |
| Health care cost tread: Ultimate | 4.50% | 4.50% | 4.75% |
| Year ultimate reached | 2016 | 2016 | 2009 |

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The following table presents the estimated benefit payments for each of the next five years and the aggregate amount expected to be paid in years six through ten:

| | |
|---------------|--|
| Calendar Year | |
|---------------|--|

| | |
|-----------|-----------|
| 2008 | \$104,000 |
| 2009 | \$109,000 |
| 2010 | \$121,000 |
| 2011 | \$126,000 |
| 2012 | \$119,000 |
| 2013-2017 | \$553,000 |

The Corporation's policy is to contribute the amount required to fund postretirement benefits as they become due to retirees. The amount expected to be required in contributions to the plan during 2008 is \$104,000.

The Corporation also sponsors an Executive Supplemental Pension Plan for certain current and former executive officers to restore certain pension benefits that may be reduced due to limitations under the Internal Revenue Code. The benefits under this plan are unfunded as of December 31, 2007 and 2006.

The Corporation uses a December 31 measurement date for its Executive Supplemental Pension Plan.

| | <u>2007</u> | <u>2006</u> |
|--------------------------------------------------|-------------------|-------------------|
| Change in benefit obligation: | | |
| Benefit obligation at beginning of year | \$ 824,054 | \$ 807,011 |
| Service cost | 15,981 | - |
| Interest cost | 48,815 | 45,802 |
| Actuarial loss (gain) | 47,547 | (7,839) |
| Benefits paid | <u>(20,920)</u> | <u>(20,920)</u> |
| Projected benefit obligation at end of year | <u>\$ 915,477</u> | <u>\$ 824,054</u> |
| Changes in plan assets: | | |
| Fair value of plan assets at beginning of year | \$ - | \$ - |
| Employer contributions prior to measurement date | 20,920 | 20,920 |
| Benefits paid | <u>(20,920)</u> | <u>(20,920)</u> |
| Fair value of plan assets at end of year | <u>\$ -</u> | <u>\$ -</u> |
| Unfunded status | \$(915,477) | \$(824,054) |

Amounts recognized in accumulated other comprehensive income at December 31, 2007 and 2006 consist of the following:

| | <u>2007</u> | <u>2006</u> |
|--------------------|-------------|-------------|
| Net actuarial loss | \$ 129,952 | \$ 131,881 |

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| | | |
|--------------------------|-------------------|-------------------|
| Prior service cost | 4 | <u>1,452</u> |
| Total before tax effects | <u>\$ 129,956</u> | <u>\$ 133,333</u> |

Accumulated benefit obligation at December 31, 2007 and 2006 was \$909,272 and \$780,917, respectively.

| | | | |
|----------------------------------------------------------------|-------------|-------------|-------------|
| Weighted-average assumption for disclosure as of December 31,: | <u>2007</u> | <u>2006</u> | <u>2005</u> |
| Discount rate | 6.00% | 6.00% | 5.75% |
| Assumed rate of future compensation increase | 5.00% | 5.00% | 5.00% |

The components of net periodic benefit cost for the years ended December 31, 2007, 2006 and 2005 are as follows:

| | | | |
|----------------------------------------------------------------------------------------------|-------------------|-------------------|------------------|
| Net periodic benefit cost | <u>2007</u> | <u>2006</u> | <u>2005</u> |
| Service cost | \$ 15,981 | \$ - | \$ 1,834 |
| Interest cost | 48,815 | 45,802 | 44,131 |
| Recognized prior service cost | 1,448 | 1,448 | 1,448 |
| Recognized actuarial loss | <u>49,476</u> | <u>59,018</u> | <u>44,073</u> |
| Net periodic postretirement benefit cost | <u>\$ 115,720</u> | <u>\$ 106,268</u> | <u>\$ 91,486</u> |
| Other changes in plan assets and benefit obligation recognized in other comprehensive income | | | |
| Net actuarial loss | \$ 47,547 | | |
| Recognized actuarial (loss) | (49,476) | | |
| Recognized prior service cost | <u>(1,448)</u> | | |
| Total recognized in other comprehensive income (before tax effect) | <u>\$ (3,377)</u> | | |
| Total recognized in net benefit cost and other comprehensive income (before tax effect) | <u>\$ 112,343</u> | | |

Amounts expected to be recognized in net periodic cost during 2008:

| | |
|--------------------------------|---------|
| Loss recognition | \$4,000 |
| Prior service cost recognition | \$ 4 |

Weighted-average assumptions for net periodic cost as of December 31,:

| | | | |
|---------------|-------------|-------------|-------------|
| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
| Discount rate | 6.00% | 5.75% | 6.00% |
| Salary scale | 5.00% | 5.00% | 5.00% |

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The following table presents the estimated benefit payments for each of the next five years and the aggregate amount expected to be paid in years six through ten for the Supplemental Pension Plan:

| <u>Calendar Year</u> | <u>Future Estimated Benefit Payments</u> |
|----------------------|----------------------------------------------|
| 2008 | \$ 71,000 |
| 2009 | \$ 88,000 |
| 2010 | \$ 88,000 |
| 2011 | \$ 88,000 |
| 2012 | \$ 88,000 |
| 2013-2017 | \$440,000 |

The Corporation expects to contribute \$71,000 to the plan during 2008. Corporation contributions are equal to the benefit payments to plan participants.

(12) STOCK COMPENSATION

On December 21, 2005, the Corporation's Board of Directors approved an adjustment to the compensation of board members so that members of the Board of Directors receive common shares of the Corporation equal in value to the amount of fees individually earned during the previous year for service as a member of the Board of Directors. The common shares are to be distributed to the Corporation's individual board members from treasury shares of the Corporation on or about January 15 following the calendar year of service.

Additionally, the President and CEO of the Corporation, who does not receive cash compensation as a member of the Board of Directors, shall be awarded common shares equal in value to the average of those awarded to board members not employed by the Corporation who have served twelve (12) months during the prior year.

An expense of \$224 thousand related to this compensation was recognized during the year of 2007. During January 2008, 8,227 shares were re-issued from treasury to fund the stock component of directors' compensation.

(13) RELATED PARTY TRANSACTIONS

Members of the Board of Directors, certain Corporation officers, and their immediate families directly, or through entities in which they are principal owners (more than 10% interest), were customers of, and had loans and other transactions with, the Corporation in the ordinary course of business. These loans and commitments are summarized as follows for the years ended December 31, 2007 and 2006:

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| | <u>2007</u> | <u>2006</u> |
|----------------------------------|---------------------|----------------------|
| Balance at beginning of year | \$ 11,171,446 | \$ 18,938,044 |
| New loans or additional advances | 8,695,647 | 25,711,176 |
| Repayments | <u>(10,284,738)</u> | <u>(33,477,774)</u> |
| Balance at end of year | <u>\$ 9,582,355</u> | <u>\$ 11,171,446</u> |

Deposits from principal officers, directors, and their affiliates at year-end 2007 were \$16,809,206.

(14) EXPENSES

The following expenses, which exceeded 1% of total revenues (total interest income plus other operating income) in at least one of the years presented, are included in other operating expenses:

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|--------------------------------------|-------------|-------------|-------------|
| Data processing and software | \$3,802,642 | \$3,969,789 | \$3,330,209 |
| Marketing and advertising | 962,538 | 1,036,016 | 950,105 |
| Professional services | 585,654 | 694,364 | 675,554 |
| Loan administration and OREO expense | 663,118 | 1,134,462 | 502,597 |

(15) COMMITMENTS AND CONTINGENCIES

Some financial instruments, such as loan commitments, credit lines, letters of credit, and overdraft protection, are issued to meet customer financing needs. These are agreements to provide credit or to support the credit of others, as long as conditions established in the contract are met, and usually have expiration dates. Commitments may expire without being used. Off-balance sheet risk to credit loss exists up to the face amount of these instruments, although material losses are not anticipated. The

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same credit policies are used to make such commitments as are used for loans, including obtaining collateral at exercise of the commitment.

The contractual amounts of financial instruments with off-balance sheet risk at year-end were as follows:

| | <u>2007</u> | | <u>2006</u> | |
|---------------------------|-------------------|----------------------|-------------------|----------------------|
| | <u>Fixed Rate</u> | <u>Variable Rate</u> | <u>Fixed Rate</u> | <u>Variable Rate</u> |
| Commitments to make loans | \$ 9,368,446 | \$ 1,251,823 | \$15,911,970 | \$ 10,482,344 |

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| | | | | |
|---------------------------|--------------|---------------|--------------|---------------|
| Unused lines of credit | \$ 1,395,190 | \$122,925,710 | \$ 1,079,857 | \$114,668,042 |
| Standby letters of credit | \$ - | \$ 11,487,214 | \$ - | \$ 11,320,350 |

Because many commitments and almost all standby letters of credit expire without being funded in whole or in part, the contract amounts are not estimates of future cash flows. Loan commitments and unused lines of credit have off-balance sheet credit risk because only origination fees are recognized on the consolidated balance sheet until commitments are fulfilled or expire. The credit risk amounts are equal to the contractual amounts, assuming the amounts are fully advanced and collateral or other security is of no value. The Corporation does not anticipate losses as a result of these transactions. These commitments also have off-balance sheet interest rate risk in that the interest rate at which these commitments were made may not be at market rates on the date the commitments are fulfilled.

The Corporation has issued conditional commitments in the form of standby letters of credit to guarantee payment on behalf of a customer and guarantee the performance of a customer to a third party. Standby letters of credit generally arise in connection with lending relationships. The credit risk involved in issuing these instruments is essentially the same as that involved in extending loans to customers. Contingent obligations under standby letters of credit totaled \$11.487 million at December 31, 2007 and represent the maximum potential future payments the Corporation could be required to make. Typically, these instruments have terms of twelve months or less and expire unused; therefore, the total amounts do not necessarily represent future cash requirements. Each customer is evaluated individually for creditworthiness under the same underwriting standards used for commitments to extend credit and on-balance sheet instruments. Corporation policies governing loan collateral apply to standby letters of credit at the time of credit extension. The carrying amount and fair value of the Corporation's standby letters of credit at December 31, 2007 was not significant.

The Corporation has employment contracts with certain of its senior officers, which expire at various dates through 2008 and may be extended on a year-to-year basis.

In the normal course of business, there are various outstanding legal proceedings involving the Corporation or its subsidiaries. In the opinion of management, the aggregate amount involved in such proceedings is not material to the financial condition or results of operations of the Corporation.

(16) SHAREHOLDERS' EQUITY

The Bank is subject to legal limitations on the amount of dividends that can be paid to the Corporation without prior regulatory approval. Dividends are limited to retained net profits, as defined by regulations, for the current year and the two preceding years. At December 31, 2007, approximately \$5.9 million was available for the declaration of dividends from the Bank to the Corporation.

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(17) PARENT COMPANY FINANCIAL INFORMATION

Condensed parent company only financial statement information of Chemung Financial Corporation is as follows (investment in subsidiaries is recorded using the equity method of accounting):

| | <u>2007</u> | <u>2006</u> | |
|--------------------------------------------------------|----------------------|----------------------|--------------|
| BALANCE SHEETS - DECEMBER 31 | | | |
| Assets: | | | |
| Cash on deposit with subsidiary bank | \$ 624,313 | \$ 484,190 | |
| Investment in subsidiary-Chemung Canal Trust Company | 84,446,122 | 78,662,718 | |
| Investment in subsidiary-CFS Group, Inc. | 212,104 | 211,203 | |
| Dividends receivable from subsidiary bank | 879,682 | 848,989 | |
| Securities available for sale, at estimated fair value | 302,752 | 217,625 | |
| Other assets | <u>2,565,426</u> | <u>2,919,812</u> | |
| Total assets | <u>\$ 89,030,399</u> | <u>\$ 83,344,537</u> | |
| Liabilities and shareholders' equity: | | | |
| Dividends payable | 879,682 | 848,989 | |
| Other liabilities | <u>35,767</u> | <u>197,287</u> | |
| Total liabilities | <u>915,449</u> | <u>1,046,276</u> | |
| Shareholders' equity: | | | |
| Total shareholders' equity | <u>88,114,950</u> | <u>82,298,261</u> | |
| Total liabilities and shareholders' equity | <u>\$ 89,030,399</u> | <u>\$ 83,344,537</u> | |
| STATEMENTS OF INCOME - YEARS ENDED | | | |
| DECEMBER 31 | | | |
| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
| Dividends from subsidiary bank | \$ 3,913,259 | \$ 5,172,024 | \$ 4,971,081 |
| Interest and dividend income | 28,092 | 25,523 | 13,042 |

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| | | | |
|-----------------------------------------------------------------------------------|---------------------|---------------------|---------------------|
| Other income | 204,428 | 487,661 | 236,432 |
| Operating expenses | <u>(179,899)</u> | <u>(137,224)</u> | <u>(136,654)</u> |
| Income before impact of subsidiaries' earnings and distributions and income taxes | 3,965,880 | 5,547,984 | 5,083,901 |
| Equity in undistributed earnings of Chemung Canal Trust Company | 3,253,187 | 1,141,876 | 1,455,348 |
| Equity in undistributed (losses) earnings of CFS Group, Inc. | <u>901</u> | <u>(23,537)</u> | <u>17,360</u> |
| Income before income tax | 7,219,968 | 6,666,323 | 6,556,609 |
| Income tax (benefit) expense | <u>(39,415)</u> | <u>77,757</u> | <u>(32,932)</u> |
| Net Income | <u>\$ 7,259,383</u> | <u>\$ 6,588,566</u> | <u>\$ 6,589,541</u> |

STATEMENTS OF CASH FLOWS - YEARS ENDED
DECEMBER 31

| | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|-------------------------------------------------------------------------------------|------------------|------------------|------------------|
| Cash flows from operating activities: | | | |
| Net Income | \$ 7,259,383 | \$ 6,588,566 | \$ 6,589,541 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | | |
| Equity in undistributed earnings of Chemung Canal Trust Company | (3,253,187) | (1,141,876) | (1,455,348) |
| Equity in undistributed losses (earnings) of CFS Group, Inc. | (901) | 23,537 | (17,360) |
| (Increase) decrease in dividend receivable | (30,693) | 14,784 | 13,877 |
| Decrease (increase) in other assets | 354,386 | (287,488) | 32,051 |
| (Decrease) increase in other liabilities | 32,071 | 282,847 | (123,943) |
| Expense related to employee stock compensation | 29,000 | 33,000 | - |
| Expense related to restricted stock units for directors' deferred compensation plan | 84,867 | 82,241 | 160,252 |
| Directors' compensation stock grants | = | = | <u>240,898</u> |
| Net cash provided by operating activities | <u>4,474,926</u> | <u>5,595,611</u> | <u>5,439,968</u> |
| Cash flow from investing activities: | | | |
| Purchase of securities available for sale | <u>(100,000)</u> | = | = |
| Net cash provided by investing activities | <u>(100,000)</u> | = | = |
| Cash flow from financing activities: | | | |
| Cash dividends paid | (3,382,566) | (3,436,808) | (3,484,958) |
| Purchase of treasury stock | (1,239,262) | (2,265,310) | (2,288,085) |

| | | | |
|--------------------------------------------------|--------------------|--------------------|--------------------|
| Sale of treasury stock | <u>387,025</u> | = | = |
| Net cash used in financing activities | <u>(4,234,803)</u> | <u>(5,702,118)</u> | <u>(5,773,043)</u> |
| Increase (decrease) in cash and cash equivalents | 140,123 | (106,507) | (333,075) |
| Cash and cash equivalents at beginning of year | <u>484,190</u> | <u>590,697</u> | <u>923,772</u> |
| Cash and cash equivalents at end of year | <u>\$ 624,313</u> | <u>\$ 484,190</u> | <u>\$ 590,697</u> |

(18) FAIR VALUES OF FINANCIAL INSTRUMENTS

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

Short-Term Financial Instruments

For those short-term instruments that generally mature in ninety days or less, the carrying value approximates fair value.

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Securities

Fair values for securities are based on either 1) quoted market prices, 2) dealer quotes, 3) a correspondent bank's pricing system, or 4) discounted cash flows to maturity. For certain securities, such as equity investments in the FHLB and Federal Reserve Bank, and non-marketable obligations of political subdivisions, fair value is estimated to approximate amortized cost.

Loans Receivable

For variable-rate loans that reprice frequently, fair values approximate carrying values. The fair values for other loans are estimated through discounted cash flow analysis using interest rates currently being offered for loans with similar terms and credit quality.

Deposits

The fair values disclosed for demand deposits, savings accounts and money market accounts are, by definition, equal to the amounts payable on demand at the reporting date (i.e., their carrying values).

The fair value of certificates of deposits is estimated using a discounted cash flow approach that applies interest rates currently being offered on certificates to a schedule of the weighted-average expected monthly maturities.

Securities Sold Under Agreements to Repurchase (Repurchase Agreements)

These instruments bear both variable and fixed rates of interest. Therefore, the carrying value approximates fair value for the variable rate instruments and the fair value of fixed rate instruments is based on discounted cash flows to maturity.

Federal Home Loan Bank Advances

These instruments bear a stated rate of interest to maturity and, therefore, the fair value is based on discounted cash flows to maturity.

Commitments to Extend Credit

The fair value of commitments to extend credit is based on fees currently charged to enter into similar agreements, the counter-party's credit standing and discounted cash flow analysis. The fair value of these commitments to extend credit approximates the recorded amounts of the related fees and is not material at December 31, 2007 and 2006.

Accrued Interest Receivable and Payable

For these short-term instruments, the carrying value approximates fair value.

The estimated fair value of the Corporation's financial instruments as of December 31, 2007 and 2006 are as follows (dollars in thousands):

| | <u>2007</u> | | <u>2006</u> | |
|-----------------------------------------------------------|-----------------|--------------------------|-----------------|--------------------------|
| | Carrying Amount | Estimated Fair Value (1) | Carrying Amount | Estimated Fair Value (1) |
| <u>Financial assets:</u> | | | | |
| Cash and due from financial institutions | \$ 29,096 | \$29,096 | \$ 26,344 | 26,344 |
| Interest-bearing deposits in other financial institutions | 283 | 283 | 246 | 246 |
| Securities available for sale | 165,321 | 165,321 | 184,830 | 184,830 |
| Securities held to maturity | 4,480 | 4,575 | 6,866 | 6,877 |
| Federal Home Loan and Federal Reserve Bank stock | 5,901 | 5,901 | 3,605 | 3,605 |
| Net loans | 531,070 | 537,549 | 469,681 | 466,557 |
| Loans held for sale | 39 | 39 | - | - |
| Accrued interest receivable | 3,452 | 3,452 | 3,312 | 3,312 |
| <u>Financial liabilities:</u> | | | | |
| Deposits: | | | | |
| Demand, savings, and insured money market accounts | 345,429 | 345,429 | 354,479 | 354,479 |
| Time deposits | 227,171 | 227,849 | 230,613 | 230,778 |

| | | | | |
|------------------------------------------------|--------|--------|--------|--------|
| Securities sold under agreements to repurchase | 31,212 | 32,541 | 35,024 | 35,164 |
| Federal Home Loan Bank overnight advances | 62,400 | 62,400 | 7,900 | 7,900 |
| Federal Home Loan Bank advances | 20,000 | 22,127 | 20,000 | 20,104 |
| Accrued interest payable | 1,292 | 1,292 | 1,323 | 1,323 |
| Dividends payable | 880 | 880 | 849 | 849 |

(1) Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instrument. These estimates are subjective in nature and involve uncertainties and matters of significant judgement and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

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(19) REGULATORY CAPITAL REQUIREMENTS

The Corporation and the Bank are 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 effect on the consolidated financial statements. Under capital adequacy guidelines and the regulatory framework for prompt corrective action, the Bank must meet specific capital guidelines that involve quantitative measures of the Bank's assets, liabilities, and certain off-balance sheet items as calculated under regulatory accounting practices. The capital amounts and classifications are also subject to qualitative judgments by the regulators about components, risk weightings, and other factors.

Quantitative measures established by regulation to ensure capital adequacy require the Corporation and the Bank to maintain minimum amounts and ratios (set forth in the table below) of total and Tier 1 capital to risk-weighted assets, and of Tier 1 capital to average assets (all as defined in the applicable regulations). Management believes that, as of December 31, 2007 and 2006, the Corporation and the Bank met all capital adequacy requirements to which they were subject.

As of December 31, 2007, the most recent notification from the Federal Reserve Bank of New York categorized the Bank as well capitalized under the regulatory framework for prompt corrective action. To be categorized as well capitalized the Bank must maintain minimum total risk-based, Tier 1 risk-based and Tier 1 leverage ratios as set forth in the table below. There have been no conditions or events since that notification that management believes have changed the Bank's or the Corporation's capital category.

The actual capital amounts and ratios of the Corporation and the Bank are presented in the following table:

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| <u>As of December 31, 2007</u> | <u>Actual</u> | | <u>Required To Be Adequately Capitalized</u> | | <u>Required To Be Well Capitalized</u> | |
|------------------------------------------|---------------|--------------|----------------------------------------------|--------------|----------------------------------------|--------------|
| | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> | <u>Amount</u> | <u>Ratio</u> |
| Total Capital(to Risk Weighted Assets): | | | | | | |
| Consolidated | \$87,269,125 | 15.78% | \$44,254,012 | 8.00% | \$55,317,515 | 10.00% |
| Bank | \$83,578,333 | 15.19% | \$44,023,112 | 8.00% | \$55,028,890 | 10.00% |
| Tier 1 Capital(to Risk Weighted Assets): | | | | | | |
| Consolidated | \$76,582,379 | 13.84% | \$22,127,006 | 4.00% | \$33,190,509 | 6.00% |
| Bank | \$72,964,924 | 13.26% | \$22,011,556 | 4.00% | \$33,017,334 | 6.00% |
| Tier 1 Capital(to Average Assets): | | | | | | |
| Consolidated | \$76,582,379 | 10.14% | \$22,658,049 | 3.00% | \$37,763,416 | 5.00% |
| Bank | \$72,964,924 | 9.70% | \$22,569,927 | 3.00% | \$37,616,545 | 5.00% |
| <u>As of December 31, 2006</u> | | | | | | |
| Total Capital(to Risk Weighted Assets): | | | | | | |
| Consolidated | \$87,557,306 | 17.11% | \$40,942,623 | 8.00% | \$51,178,279 | 10.00% |
| Bank | \$83,898,555 | 16.50% | \$40,689,617 | 8.00% | \$50,862,021 | 10.00% |
| Tier 1 Capital(to Risk Weighted Assets): | | | | | | |
| Consolidated | \$77,359,370 | 15.12% | \$20,471,312 | 4.00% | \$30,706,968 | 6.00% |
| Bank | \$73,784,061 | 14.51% | \$20,344,808 | 4.00% | \$30,517,213 | 6.00% |
| Tier 1 Capital(to Average Assets): | | | | | | |
| Consolidated | \$77,359,370 | 10.80% | \$21,483,464 | 3.00% | \$35,805,774 | 5.00% |
| Bank | \$73,784,061 | 10.35% | \$21,395,526 | 3.00% | \$35,659,210 | 5.00% |

(20) COMPREHENSIVE INCOME (LOSS)

Comprehensive income or loss of the Corporation represents net income plus other comprehensive income or loss, which consists of the net change in unrealized holding gains or losses on securities available for sale and the change in the funded status of the Corporation's defined benefit pension plan and other benefit plans, net of the related tax effect. Accumulated other comprehensive income or loss represents the net unrealized holding gains or losses on securities available for sale and the change in the funded status of the Corporation's defined benefit pension plan and other benefit plans, as of the consolidated balance sheet dates, net of the related tax effect.

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Comprehensive income (loss) for the years ended December 31, 2007, 2006, and 2005 was \$9,723,220, \$6,851,491, and \$4,287,168, respectively. The following summarizes the components of other comprehensive income (loss) and related tax effects:

| Other Comprehensive Income (Loss) | <u>2007</u> | <u>2006</u> | <u>2005</u> |
|---------------------------------------------------------------------------------|---------------------|-------------------|----------------------|
| Change in unrealized holding gains (losses) on securities available for sale | \$3,228,315 | \$ 457,240 | \$(3,765,290) |
| Reclassification adjustment net gains realized in net income | <u>(9,680)</u> | <u>(26,570)</u> | <u>(6,000)</u> |
| Net unrealized gains | 3,218,635 | 430,671 | (3,771,290) |
| Tax effect | <u>(1,232,508)</u> | <u>(167,746)</u> | <u>1,468,917</u> |
| Net of tax amount | \$1,986,127 | \$ 262,925 | \$(2,302,373) |
| Change in funded status of defined benefit pension plan and other benefit plans | 779,122 | - | - |
| Tax effect | <u>(301,412)</u> | = | = |
| Net of tax amount | <u>477,710</u> | = | = |
| Total other comprehensive income (loss) | <u>\$ 2,463,837</u> | <u>\$ 262,925</u> | <u>\$(2,302,373)</u> |

(21) SEGMENT REPORTING

The Corporation manages its operations through two primary business segments: core banking and trust and investment advisory services. The core banking segment provides revenues by attracting deposits from the general public and using such funds to originate consumer, commercial, commercial real estate, and residential mortgage loans, primarily in the Corporation's local markets and to invest in securities. The trust and investment advisory services segment provides revenues by providing trust and investment advisory services to clients.

Accounting policies for the segments are the same as those described in Note 1. Summarized financial information concerning the Corporation's reportable segments and the reconciliation to the Corporation's consolidated results is

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shown in the following table. Income taxes are allocated based on the separate taxable income of each entity and indirect overhead expenses are allocated based on reasonable and equitable allocations applicable to the reportable segment. Holding company amounts are the primary differences between segment amounts and consolidated totals, and are reflected in the Holding Company and Other column below, along with amounts to eliminate transactions between segments. (dollars in thousands)

| | <u>Core Banking</u> | <u>Trust & Investment Advisory Services</u> | <u>Holding Company And Other</u> | <u>Consolidated Totals</u> |
|-----------------------------------------------------|-------------------------|-------------------------------------------------------------|----------------------------------------------|--------------------------------|
| Year ended December 31, 2007 | | | | |
| Net interest income | \$ 25,902 | \$ - | \$ 34 | \$ 25,936 |
| Provision for loan losses | <u>1,255</u> | - | - | <u>1,255</u> |
| Net interest income after provision for loan losses | 24,647 | - | 34 | 24,681 |
| Other operating income | 9,857 | 6,345 | 426 | 16,628 |
| Other operating expenses | <u>24,319</u> | <u>5,795</u> | <u>406</u> | <u>30,520</u> |
| Income before income tax expense | 10,185 | 550 | 54 | 10,789 |
| Income tax expense | <u>3,356</u> | <u>213</u> | <u>(39)</u> | <u>3,530</u> |
| Segment net income | <u>\$ 6,829</u> | <u>\$ 337</u> | <u>\$ 93</u> | <u>\$ 7,259</u> |
| Segment assets | <u>\$778,158</u> | <u>\$ 7,819</u> | <u>\$2,897</u> | <u>\$ 788,874</u> |
| Year ended December 31, 2006 | | | | |
| Net interest income | \$ 24,514 | \$ - | \$ 32 | \$ 24,546 |
| Provision for loan losses | <u>125</u> | - | - | <u>125</u> |
| Net interest income after provision for loan losses | 24,389 | - | 32 | 24,421 |
| Other operating income | 8,737 | 4,901 | 674 | 14,312 |
| Other operating expenses | <u>24,812</u> | <u>4,342</u> | <u>369</u> | <u>29,523</u> |
| Income before income tax expense | 8,314 | 559 | 337 | 9,210 |
| Income tax expense | <u>2,341</u> | <u>218</u> | <u>62</u> | <u>2,621</u> |
| Segment net income | <u>\$ 5,973</u> | <u>\$ 341</u> | <u>\$ 275</u> | <u>\$ 6,589</u> |
| Segment assets | <u>\$734,086</u> | <u>\$ 908</u> | <u>\$3,176</u> | <u>\$ 738,170</u> |

Year ended December 31, 2005

| | | | | |
|-----------------------------------------------------|------------------|-----------------|----------------|-------------------|
| Net interest income | \$ 24,720 | \$ - | \$ 17 | \$ 24,737 |
| Provision for loan losses | <u>1,300</u> | = | = | <u>1,300</u> |
| Net interest income after provision for loan losses | 23,420 | - | 17 | 23,437 |
| Other operating income | 7,453 | 5,095 | 466 | 13,014 |
| Other operating expenses | <u>22,449</u> | <u>4,525</u> | <u>342</u> | <u>27,316</u> |
| Income before income tax expense | 8,424 | 570 | 141 | 9,135 |
| Income tax expense | <u>2,346</u> | <u>221</u> | <u>(22)</u> | <u>2,545</u> |
| Segment net income | <u>\$ 6,078</u> | <u>\$ 349</u> | <u>\$ 163</u> | <u>\$ 6,590</u> |
| Segment assets | <u>\$713,999</u> | <u>\$ 1,147</u> | <u>\$2,893</u> | <u>\$ 718,039</u> |

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(22) PENDING BRANCH ACQUISITION

On November 30, 2007, the Bank entered into a Purchase and Assumption Agreement ("Agreement") with Manufacturers and Traders Trust Company ("M&T") to purchase three branch offices located in Johnson City, Vestal and Owego, New York. Pursuant to the Agreement, the bank will assume the deposit liabilities and acquire loans and other assets associated with the three branch offices. There are presently approximately \$70 million in deposits and \$15 million in loans at these offices. The bank will pay a weighted deposit premium of 12.95%. The full text of the agreement is included as Exhibit No. 2.1 to Form 8-K which was filed by the Corporation on December 4, 2007. The transaction, which has received regulatory approval, is expected to close prior to the end of the first quarter of 2008.

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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.

CHEMUNG FINANCIAL CORPORATION

DATED:
MARCH 13,
2008

By /s/ Ronald M. Bentley

Ronald M. Bentley
President and Chief Executive Officer

DATED:
MARCH 13,
2008

By /s/ John R. Battersby, Jr.

John R. Battersby, Jr.
Treasurer and Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been executed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| Signature | Title | Date |
|-----------------------------------------------------|--------------------------------------|----------------------|
| Robert E. Agan | Director | |
| <u>/s/ David J. Dalrymple</u> David J. Dalrymple | Director Chairman of the Board | March 13, 2008 |
| <u>/s/ Robert H. Dalrymple</u> | | |

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| | | |
|---------------------|----------|----------------------|
| Robert H. Dalrymple | Director | March 13, 2008 |
|---------------------|----------|----------------------|

| | | |
|---------------------------------------------------------|----------|----------------------|
| <u>/s/ Clover M. Drinkwater</u> Clover M. Drinkwater | Director | March 13, 2008 |
|---------------------------------------------------------|----------|----------------------|

| | | |
|-------------------|----------|--|
| William D. Eggers | Director | |
|-------------------|----------|--|

| | | |
|---------------------------------------------------------------------|----------|----------------------|
| <u>/s/ Stephen M. Lounsberry, III</u> Stephen M. Lounsberry, III | Director | March 13, 2008 |
|---------------------------------------------------------------------|----------|----------------------|

| | | |
|-----------------------------------------------|----------|----------------------|
| <u>/s/ Thomas K. Meier</u> Thomas K. Meier | Director | March 13, 2008 |
|-----------------------------------------------|----------|----------------------|

| | | |
|---------------------------------------------|----------|----------------------|
| <u>/s/ Ralph H. Meyer</u> Ralph H. Meyer | Director | March 13, 2008 |
|---------------------------------------------|----------|----------------------|

| | | |
|---------------------------------------------------|------------------------------------------------|----------------------|
| <u>/s/ John F. Potter</u> John F. Potter | Director | March 13, 2008 |
| Charles M. Streeter, Jr. | Director | |
| <u>/s/ Richard W. Swan</u> Richard W. Swan | Director | March 13, 2008 |
| <u>/s/ Jan P. Updegraff</u> Jan P. Updegraff | Director | March 13, 2008 |
| <u>/s/ Ronald M. Bentley</u> Ronald M. Bentley | President and Chief Executive Officer | March 13, 2008 |

EXHIBIT INDEX

Exhibit 2.1 Merger Agreement dated October 12, 2006 between Chemung Canal Trust Company and Partners Trust Financial Group, Inc. entered into as a Trust Company Agreement and Plan of Merger. Filed as Exhibit 2.1 to Registrant's Form 8-K filed with the SEC on October 12, 2006 and incorporated herein by reference.

Certificate of Incorporation of Chemung Financial Corporation dated December 20, 1984.

- 3.1
- 3.2 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated March 28, 1988.
- 3.3 Certificate of Amendment to the Certificate of Incorporation of Chemung Financial Corporation, dated May 13, 1998. Filed as Exhibit 3.4 of the Registrant's Form 10-K for the year ended December 31, 2005 and incorporated herein by reference.
- 3.4 Amended and Restated Bylaws of the Registrant, as amended to November 21, 2007. Filed as Exhibit 3.1 to Registrant's Form 8-K filed with the SEC on November 21, 2007 incorporated by reference herein.
- 4.1 Specimen Stock Certificate. Filed as Exhibit 4.1 to Registrant's Form 10-K for the year ended December 31, 2002 and incorporated herein by reference.
- 10.1 Change of Control Agreement dated September 20, 2006 between Chemung Canal Trust Company and Ronald M. Bentley, President & COO. Filed as Exhibit 10.1 to Registrant's Form 10-Q for the quarter ended September 30, 2006 and incorporated herein by reference.
- 10.2 Executive Severance Agreement dated September 20, 2006 between Chemung Canal Trust Company and Ronald M. Bentley, President & COO. Filed as Exhibit 10.2 to Registrant's Form 10-Q for the quarter ended September 30, 2006 and incorporated herein by reference.
- 10.3 Amended and Restated Deferred Directors' Fee Plan. Filed as Exhibit 10.3 of the Registrant's Form 10-K for the year ended December 31, 2005 and incorporated herein by reference.
- 10.4 Employment Agreement, dated as of November 8, 2001 between Chemung Canal Trust Company and Jan P. Updegraff, President and Chief Executive Officer. Filed as Exhibit 10.4 to Registrants' Form 10-K for the year ended December 31, 2002 and incorporated herein by reference.
- 10.5 Employment Contract Addendum dated as of November 30, 2006 between Chemung Canal Trust Company and Jan P. Updegraff, Vice Chairman and Chief Executive Officer. Filed as Exhibit 10.5 to Registrants' Form 10-K for the year ended December 31, 2006 and incorporated herein by reference.
- 10.6 Description of Arrangement for Directors' Fees. Filed as Exhibit 10.6 of the Registrant's Form 10-K for the year ended December 31, 2005 and incorporated by reference herein.
- 10.7 Employment Contract Addendum dated as of November 21, 2007 between Chemung Canal Trust Company and Jan P. Updegraff, Vice Chairman.
- 10.8 Change of Control Agreement dated August 23, 2007 Chemung Canal Trust Company and John R. Battersby, Jr., Executive Vice President Treasurer & CFO.
- 10.9 Change of Control Agreement dated August 23, 2007 between Chemung Canal Trust Company and Melinda A. Sartori, Executive Vice President
- 10.10

Change of Control Agreement dated August 23, 2007 between Chemung Canal Trust Company and James E. Corey, III, Executive Vice President

- 10.11 Purchase Agreement dated November 30, 2007 between Chemung Canal Trust Company and Manufacturers and Traders Trust Company. Filed as Exhibit 2.1 to Registrant's Form 8-K filed with the SEC on December 4, 2007 and incorporated herein by reference.

- 21 Subsidiaries of the Registrant.

- 23.1 Consent of Crowe Chizek and Company LLC, Independent Registered Public Accounting Firm.

- 23.2 Consent of KPMG, LLP Independent Registered Public Accounting Firm.

- 31.1 Certification of President Chief Executive Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.

- 31.2 Certification of Treasurer and Chief Financial Officer of the Registrant pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934.

- 32.1 Certification of President and Chief Executive Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 19 U.S.C. 1350.

- 32.2 Certification of Treasurer and Chief Finance Officer of the Registrant pursuant to Rule 13a-14(b) under the Securities Exchange Act of 1934 and 19 U.S.C. 1350.